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FREE ENTERPRISE—NATIONAL AND
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P R E F A C E

THESE papers, presented under the title "Free Enterprise—National and International", comprise the PROCEEDINGS of the Academy of Political Science at its Semi-Annual Meeting, held on April 17, 1947, at the Hotel Astor in New York City. They emphasize various aspects of the problems of freedom and responsibility within the framework of our economic system. Though there is no monotonous repetition of ideas, there is substantial agreement on the necessity for a close coördination of foreign and domestic policies. The management of the public debt, the rôle of small business, the formulation of a tax program cannot be separated from the broad implications of international trade agreements, overseas investments and loans, and foreign economic systems. For Americans the possibility of maintaining free enterprise may well depend upon the extent to which other nations plan their economies and the goals toward which those plans are directed.

The Academy here acknowledges the great debt which it owes to the participants in this timely symposium. It also extends thanks to the Committee on Program and Arrangements, which included among its members Philip D. Reed (Chairman), Miss Ethel Warner (Director), B. H. Beckhart, W. Randolph Burgess, John W. Davis, Lewis W. Douglas, Frank D. Fackenthal, Pierre Jay, Nicholas Kelley, Grayson L. Kirk, Thomas W. Lamont, Russell C. Leffingwell, Sam A. Lewisohn, Henry R. Luce, Charles Merz, Frederick C. Mills, Shepard Morgan, William L. Ransom, George Roberts, David Sarnoff, Alfred P. Sloan, Jr., Arthur Hays Sulzberger, Juan T. Trippe, Eliot Wadsworth, Leo Wolman.

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PART I

THE GOVERNMENT'S ROLE IN FREE ENTERPRISE

INTRODUCTION *

SHEPARD MORGAN, *Presiding*

Vice-President, Chase National Bank of the City of New York
Director of the Academy of Political Science

THIS is the first session of the Semi-Annual Meeting of the Academy of Political Science; and this is the sixty-seventh year of the Academy's useful life. We meet here twice a year and, according to our several lights, consider the problems confronting the United States and sometimes the problems that confront the world. We do what we can to arrive at rational conclusions, though we never pass resolutions. Very wisely, I think, the by-laws that govern our activities forbid resolutions. To my mind, if we were permitted to pass them, resolutions would do more harm than good, for we do not and cannot exercise any law-making function. Our function, indeed, is one that, under the American system, must come before the making of law.

That function, as I see it, is to take part in the formation of public opinion, and preliminary to that is the all-essential task of making up our own minds—yours and mine as individuals—about matters that concern the United States and its place in

* Opening remarks at the First Session of the Semi-Annual Meeting.

the world. To make up our own minds, we need information and the mature judgments of others who, for one reason or another, know more about this or that current issue than we do ourselves. These two things the Academy aims to supply through these meetings and through its ably edited publication, the *Political Science Quarterly*.

We aim to have free discussion representing many points of view, not only by our speakers and writers, but, if they wish to join, from those who come to our meetings. The purpose is for each one of us, in his own individual capacity, to arrive at a new or at least a clearer conception concerning the matters under discussion. Under the laws of the United States, we then have the right, along with others who may differ with us, to take part, either for ourselves or through our elected representatives, in the decisions which will determine action. This is idealism but it is the idealism of democracy.

Once or twice before at these meetings, I have outlined what prompted the establishment of the Academy sixty-seven years ago. I shall recall it to you briefly now, for it is pertinent to our discussion this morning.

The story takes us back some seventeen years before the time the Academy was founded, to a battlefield of the Civil War, on a winter night of 1863. A young Union soldier was on sentry duty in western Tennessee, at a spot identified as being near Davy Crockett's Fort. As he kept watch, he began to consider why he was there and what could be done in the future to make the kind of world where sentries would not be needed and wars would not be fought. He thought the best chances of avoiding conflict came when people understood each other, when they met and talked things over, for in that way different points of view might be reconciled.

That sentry was John W. Burgess, who became the distinguished dean of the Faculty of Political Science at Columbia University and was the principal founder of the Academy of Political Science; so, you see, the Academy was founded on an idea, the idea that men have a better chance of settling their differences if they sit down and talk things over. There is surely a richness of thought that comes from hearing both sides of the question—or all sides, for frequently in this life the problems we have tried to cope with are multilateral.

In this series of sessions of the Academy, the general topic for discussion is "Free Enterprise—National and International". I suppose there is scarcely a more controversial subject in the world than that, and yet, in an American audience, there may not be very much difference of opinion. For us, it is more a question of the mechanism under which free enterprise can be maintained and operated.

The first speaker on the topic for this morning's discussion, "The Government's Rôle in Free Enterprise", is an old friend of the Academy and an old friend of these meetings. He usually sits where I am to sit this morning. It is some years since he delivered a paper at an Academy meeting. He is a past president of the Academy. He was an officer of the Federal Reserve Bank of New York for years. He then became Vice-Chairman of the National City Bank, and just now he has been occupied in a study for the Falk Foundation Committee on the management of the public debt, a subject on which he is amply qualified to pass judgment and on which he is to speak to us now. Dr. Burgess!

FREE ENTERPRISE AND THE MANAGEMENT OF THE PUBLIC DEBT

W. RANDOLPH BURGESS

Chairman of the Falk Foundation Committee on the Management
of the Public Debt

A LITTLE over a year ago, I was persuaded to be chairman of a committee to study the public debt. We gathered together a group of people who, we thought, knew a good deal about it and we farmed the job out, asking Mr. A to write a paper on interest rates and Mr. B on the banks, and so on.

We have issued, so far, three studies. Most of you, I think, have seen them; if you have not and want to, write to my office and we will send them to you. They deal with the history of the public debt, a chapter written by General Ayres; "The Public Debt and the Banks", written by Roy Reiersen of the Bankers Trust Company; and "The Public Debt and Interest Rates", written by James O'Leary, Professor at Duke University. There are three more coming. One is in the press—"The Public Debt and the Insurance Companies". Another is now being labored over—"The Public Debt and the Budget", which is a very live topic. The sixth will be our conclusions.

I had a selfish motive in accepting the invitation to speak to you this morning, because I thought that by trying to outline to you some of the conclusions that seem to me to arise from the facts as we have assembled them and analyzed them, I might get some reactions and find out whether our tentative conclusions would stand up.

Therefore, what I want to give you today are a few tentative conclusions, particularly as they relate to the American system of free enterprise as we have known it.

It is called "Free Enterprise" in the program. I suspect that is an invitation for somebody on the program to point out

that free enterprise is not free and has not been free for many, many years. I shall not respond to that alluring invitation, but take it as it stands and talk about the debt in its relation to enterprise.

The United States is worried today about the public debt. The fact that the Senate has insisted that there should be a certain retirement of the debt is an indication of a good healthy concern. We need, however, to examine that concern and see that we are bothered about the right things and that we do something about them.

I think most people's concern about the debt is a little vague and nebulous, as we in fact found our own ideas were when we tried to set them down in black-and-white type. We found we needed to dig deeper and to go behind the appearances.

Most of us, at first, when we think of that towering 260 billion dollars of debt, have some fear that that great structure is going to fall down and crush us at some point; that somehow there will be a repudiation of the debt, or that the time might come when the Treasury, with its 55 billion dollars of issues that mature within a year, might find a market that was not receptive to the rolling over of those issues, and then might run into some kind of terrible jam.

As you analyze the matter, probably neither one of those fears is justified. The real danger of the debt is something much more subtle than that and something that relates itself more nearly to our system of enterprise in this country.

The real dangers of the debt seem to me, on analysis, to be two. The first is that it dilutes the money supply—inflation; in other words, you increase the money supply faster than you increase the amount of goods to be bought with it and prices rise. The dollars look like the same dollars; they are printed in the same way, but they are not the same. They are not as powerful dollars; they do not buy as much as they did before; and, of course, that process distorts the whole economy. It means a price rise so far of some 50 per cent above pre-war level as measured by the indexes. Probably it is more than that when you measure it in terms of our individual lives as we go about and try to spend these diluted dollars. That is the obvious consequence that has impressed itself on us.

The second is less obvious but even more subtly dangerous, and that is the effect of the debt upon enterprise. That effect,

I think, we may phrase as the effect in strangling or in smothering enterprise. How does it do that? In three ways. In taxation, obviously. We know that the present tax burden ties up enterprise, keeps people from going forward with things that they would like to do. It may not look like that today, because we are still living on that bulge of spending and of deferred demand that was the natural result of the war period; but we know that new undertakings are hampered at every turn by a tax system that puts a penalty on every additional bit of effort that a person may put forth. He is not compensated for that additional effort, except by ten cents on the dollar or something of that sort, while his risk remains one hundred cents on the dollar.

Freezing Interest Rates

The second handicap to enterprise that arises from debt—and this may not have occurred to you in these terms—is the freezing of interest rates. With a huge interest burden, five billion dollars in the coming fiscal year, according to the President's estimate in his budget message, there is every temptation for the Treasury, for the politician, for anybody who feels the tax burden, to say, "Let's keep the interest rates at the lowest possible point; let's freeze them there." One must concede that a great deal has been done in that direction; that the interest rates are lower than they have ever been before in this country, or ever before in any country in the world for any marked period. That decreases the burden of the debt as far as its carrying charges go, but it affects the interest rates on every operation in the country—on all bonds, on all loans. It sets a whole new pattern, and will, as long as those controls exist.

How does that interfere with free enterprise? Though it may be a little old-fashioned, our committee believes that interest rates have an economic function to perform: that interest rates are a mechanism for adjusting the supply of savings to the demand for those savings in the form of investments of various types. If you decrease the reward to the saver, at some point you find those two things do not mesh.

There seems to be plenty of money available now. Most of it is really not saved money. It is created money, inflated money, so that you do not get today a true test of the relationship between money saved and the need for money.

There is another very important function that interest rates have, and that is as a means of placing some restraint on the movements of inflation and deflation, on the business cycle, if you will. There, again, is an old-fashioned phrase. When we talk about the business cycle today, everybody just says "full employment". But they also say, "We mustn't have a depression." Well, interest rates—and what goes with them in the form of credit control—are the long-accepted method for placing some check on the fluctuations of the business cycle.

There were, of course, many times when the method did not work well. In 1929, when we tried to stop a boom by raising interest rates, it did not stop the boom very quickly. In the thirties, low rates did not seem to stimulate business. If you go back, however, into the periods of the past, into the long years of history of the Bank of England, into what happened in this country in the twenties, you do find that credit controls through the central bank have operated at times with extraordinary effectiveness as a means to check booms and to lighten the burden when the depression comes.

People do not talk very much about that today. They talk about other methods of dealing with the swings of business and trying to stabilize them. They talk about the compensatory budget. A whole philosophy has been built up on that, in minutest detail. You find books about it that tell you just what to do under different circumstances. But nobody has ever tried it, except on a very minor scale. There may be something in it, but at least we must say that at the present stage, it is almost wholly a theory, and its application rests on decisions by the government and by the Congress particularly, because Congress will not hand over to anybody else the decisions as to how much to tax or how much to retire debt this year or how much to spend.

There are other methods that have been suggested to deal with the cycle: for example, qualitative credit control. The Federal Reserve Board has suggested that it should be given more power in telling the member banks how much short-term governments they ought to have in their portfolios and just how they should behave themselves as far as making installment loans to individuals goes. Well, there are many people who do not think that would work very well, either.

But why should we throw overboard completely the only method which, over a long period of years, has at least demonstrated some soundness and some capacity? That is the argument against freezing interest rates.

There is nothing as damaging to our system of free enterprise as great swings of the cycle with no method of modifying them. We do not want a system of individual controls of business. When the bureaucrat reaches his hand out and tries to tell people just what to do, it does not work very well. We have found from experience, however, that central banks with their influence on the quantity of money can exercise an influence on the cycle without reaching their hands in and telling everybody what to do. It is a more democratic way of doing things. It is more consistent with our system of free enterprise.

But to make that influence effective, interest rates must not be frozen. There must be some fluctuation of rates, partly as an instrument of itself in the form of changes in discount rates, partly because, when you do things to tighten up credit like selling bonds, that also affects rates.

Here, then, is the second way that this huge debt, with its huge interest burden, may interfere with the system of free enterprise: by freezing interest rates. It keeps them from performing their proper economic function.

The third way is that the huge debt tempts the government to undertake more control over our economic life than it would otherwise. I have already referred to the control through taxation, and the qualitative control of credit. When the government is spending a large amount of the national income, the temptation to put in controls becomes more and more inviting, and the danger is that there may be set up a series of controls under which free enterprise cannot operate.

To summarize, therefore, what are the economic effects of the debt as they concern our system of free enterprise? First, it dilutes the dollar; second, it has a powerful tendency to smother and strangle enterprise in these various ways.

A Debt Program

Now, I would like to suggest the kind of program for dealing with the debt that would seem to have some promise of giving our free-enterprise system a chance of dealing with this towering debt of 260 billion dollars. First on any program in dealing

with the debt is the budget, because the budget is, after all, the place where all of these things meet. The budget, as the President presents it, is a composite of spending and of taxes and of debt retirement, and the problem in the budget is to get a correct balance among those parts.

Obviously, the present budget is out of control. Thirty-seven and a half billion dollars is too big. It is thoroughly inconsistent with maintaining the sort of enterprise system in the United States to which we have been accustomed. It will mean that the government spends 25 per cent of the national income; that much of the income has to be piped through the bureaus, through all those narrow little pipes that squeeze it as it goes through. It is too big.

With the thirty-seven and a half billion dollar budget, it is contemplated that there should be no reduction of taxes, no relief of the wartime burden that was put on as a temporary method of meeting wartime demands. The budget as originally presented allowed only 200 million dollars for reduction of the debt; in other words, it made no real beginning at reducing the burden of the 260 billion dollars. That is not a realistic budget, but can we do any better?

Cutting the Budget

We must recognize that the President and the Secretary of the Treasury and the Budget Director made a vigorous attempt to bring that budget down. They did bring it down from a very much larger figure. But would anyone of us say that that budget was sacred and could not be reduced further, that there was no remaining fat, no remaining waste in the government, that could not be cut out?

We have been studying that and we believe there are very large areas for saving. The Congress has been debating whether they can cut that budget by four and a half billion dollars or by six. A cut of something like that is attainable if the effort is made.

It is very far from easy. The budget is not something that only the President and the government departments decide about. They do not have the authority to make all the decisions. In the main, they are engaged in carrying out the laws that are on the statute books, and many of those laws are very wasteful laws and involve a whole series of subsidies to pressure

groups built up over a period of fifteen years which the American people, if they really laid them on the table and surveyed them, do not want.

The only satisfactory way you can cut this budget is to change some of the governmental policies, some administrative but many embodied in laws on our statute books. The whole veterans matter has been handled with incredible waste; in a great burst of generosity that did us all credit, we adopted legislation, much of which is thoroughly wasteful and picks out some people for favoritism and outright graft.

Here is the fact that two thirds of the patients in veterans' hospitals are people suffering not from service disabilities but from some other disabilities. I could go into a veterans' hospital because I am a veteran of World War I, and if I were willing to certify that I could not afford to pay for the service in other ways, there is a bed waiting for me.

Several hundred million dollars in the budget for building new hospitals are predicated on the fact that they are intended to give service, not to veterans disabled in action, whom, heaven knows, we must take care of, but to you and me and other veterans who are willing to say we cannot afford this service some other way. In other words, it is just a long step toward socialized medicine without that label on it.

One could point out other things of that sort; but they are on the statute books and the only way you will get them changed is by changing the policies. So this business of dealing with the budget, of cutting it down to a size where we can deal with it, is not something you can do just this year. We can make a start, but to deal with it adequately is a work of a good many months and a good many years. It must be done, however, if we are going to deal with the debt in such a way that it does not interfere with our system of free enterprise.

I am tempted to say a word about the new proposals in foreign policy, in their relation to the budget. One wonders whether that means a huge additional body of spending. I do not believe that it does. This Greek and Turkish aid ought to be given and given quickly. It is part of the negotiations that are now going on. It is an indication of America's will to play its part in the world. But I think, when you analyze other situations and the whole picture, you find that this is a relatively unique strategic point.

We cannot undertake in America to feed everybody who says he would like some food and to pour out our money to everybody who would like it. We have not the resources to do that. We cannot feed the entire world. To the extent that we force it on people, we weaken the fiber of their own capacity to rise. After all, they themselves, mostly by their own efforts, have to pull themselves out of the internal troubles in which they find themselves. They need help but the help must be administered wisely and strategically if we are to fulfill the duty which falls to us.

My own belief is that the instruments that we have already created, plus certain strategic loans such as these to Greece and Turkey, will accomplish the purpose. The new International Bank is getting itself geared up to do its job and do it in a very effective way, in a way that will help people to help themselves. We ought, in area after area, rather promptly, to reach the stage where that gap can be bridged by the World Bank. Then, from there on, private enterprise, private loans in this market, and American business going through the world can take up the burden.

I do not really believe a sound foreign program is going to stand in the way of dealing with the budget. To the extent that it does, I believe that we must be prepared to pull in our belts at some other points, to modify wasteful practices, to remove some unnecessary subsidies from the budget, so that we get it down to a size that can be dealt with.

Reducing the Debt

That we must reduce the debt is obvious. We must make a beginning on pulling down this huge amount so that the interest burden will be decreased and so that its effect on bank credit and on the whole economy will be diminished. The Senate, I think, showed a commendable spirit in insisting that there should be some measure of debt reduction. Whether \$2,600,000,000 is the right figure, I do not know; but at least it is the kind of figure that should be considered.

We are already making a beginning in reducing the debt. The figures look better than they did at first. We will run a surplus for this fiscal year, and we are even now paying back the debt. Some of it was just using the balances on hand to pay debt, but it has gone beyond that. We are making a reduction

particularly in reducing the inflationary bank-held debt. That is being done technically in various ways, using the proceeds of sales of savings bonds, the social security funds and so on. The trend is in the right direction.

Distributing the Debt

Another job is to distribute the debt. The damaging part of the debt, the most dangerous part, is the debt in the hands of the banks, because that is money. That stands for active bank deposits. That is the inflationary factor. In one way or another, we must pull that debt out of the banks and put it into the hands of investors, and that process is under way.

One of the best ways is through the sale of savings bonds. That is being done pretty effectively. The Treasury is launching a new program this summer. The "Buy a Bond a Month" sounds just like some more of the war sales, but, in reality, it relates itself directly to this whole problem of dealing with the debt, for the debt will be more manageable if we get it out of the floating debt class, if we get it out of the class that has to be dealt with every month as the maturities roll around, and put it away in the hands of investors, into their safe deposit boxes, into insurance companies and so on, where it is not in the money stream.

Reducing Taxes

Furthermore, we must reduce taxes. Roswell Magill, who follows me, will tell you just how to do that, so I do not need to pause very long to talk about it. From the point of view of dealing with the debt in such a way as to restore enterprise, I think one can say this: If you examine the history of the past, it is clear that, after every great war, the people who looked at their towering debt were discouraged about it. Macaulay wrote about it after the Napoleonic wars. You can find it in the literature of our own economists after the Civil War, and certainly after World War I. They said, "How can we ever deal with this huge debt?"

Well, in England and the United States, those problems proved not to be as difficult as they were expected to be, and the reason was that the forces of enterprise carried forward so vigorously that the national income was increased and the debt became smaller and smaller in relation to the income.

I noticed Sumner Slichter published an article the other day in which he predicted that by 1960 the national income of the United States, if we were sensible about things, might be three hundred billion dollars. Well, that is a thing one ought not to let himself dream about, because it might give him nightmares; but at least it suggests that if we pursue sound policies that allow enterprise to have a chance, we can increase the volume of business and increase the income of the average family to a point where a \$7,000 debt (and that is the size of the debt per family) ceases to be so great a burden.

If you were to go through the whole range of things that could be done to release the dynamic forces of enterprise, certainly cutting of taxes is the most important, as anyone will certify who is in business in any form; and the tax cut should be directed to the place that will help the small and the growing business. What tax is that? It is the tax on individual incomes because most small business is unincorporated. It is the tax rate on individual incomes from five to fifty thousand dollars or a hundred thousand dollars that makes it extraordinarily difficult for the small business man—the fellow who, coming up from the grass roots, has always stimulated things in this country—to make progress, to build up those reserves that he needs to go forward with enterprise.

I will leave the rest of that discussion to Roswell Magill, except for one point. There is a difference of opinion among the economists about just when you should cut taxes and, in particular, there is a certain suggestion of contradiction in cutting taxes at a time of inflation. I hope Mr. Magill will take up this point and tell us all about it. It is argued that taxes are repressive; we have inflation; therefore we ought to keep taxes high. There are several difficulties about that.

One is that, as a matter of fact, taxes are to a certain measure inflationary. Look at it in wages. If you have an individual tax cut, it becomes less necessary to increase wages. It becomes easier to reduce prices. Those are two of the things that we want to do, so that, to that extent, a tax cut is anti-inflationary.

In the second place, you cannot time these things precisely. It is the old problem of whether a compensated budget can be made to operate. The Congress is now acting on the taxes that we will be paying six months and a year from now, as well as right now. What will conditions be six months and a year

from now? Some people say we will be sliding into a depression. Well, if that is true, you need all the stimulation of enterprise that you can get. But we cannot time these things with precision. You have got to do some things in relation to the longer trend rather than in relation to the immediate situation, as you interpret it. We do not always know with complete precision just what the situation is today—not to say six months from now.

The third difficulty is a very human consideration. People want a tax cut very badly. They are justified in wanting one. They have been through the war period. They have carried a heavy burden. It is a perfectly legitimate human requirement that we should move away from some of these wartime restrictions and restraints, and it is wholesome to do so because we do not want to get them fastened on us.

Unfreezing Interest Rates

Another step in a debt program is to unfreeze interest rates. I have already talked about that, in discussing the difficulties that would arise, and I shall not dwell on it. I am not arguing necessarily for an increase in rates. I am arguing for stopping the commitment that rates shall remain at some given point. You need a little uncertainty in the situation, and I speak there as an old central banker. If the central bank is going to have any influence on the flow of the business and money, it cannot go into action with its hands tied behind its back. So let us get away from the freezing commitments and leave the central bank a chance to act and give rates some chance to perform their economic function.

Improving Government

Finally, to deal with this debt wisely, we must somehow improve the quality of our national government. Whether we like it or not, the government is going to be bigger than it was. Its budget is going to be very large for a long time to come. A larger proportion of the national income will flow through the government. The government will be doing a great many more things than it has in the past. That is at the will of the people. Therefore, we cannot get along with the same standards of government competence that we have shuffled along with for a long time in the past.

Some of you may have tried to get something done in Washington, just after a change of administration, and you wander around the empty corridors, wondering where you can find somebody who knows something about the problem that you are concerned with, for the whole layer of executives has been swept out. In other words, we have lacked that adequate group of high-grade civil servants who would carry on in a bipartisan way. I say we have lacked them. That is not a fair statement. There have been notable exceptions of outstanding men who have served the public. We started at one time to have undersecretaries who would be permanent. The first one, one of the notable illustrations, was Parker Gilbert in the Treasury, who did, in fact, serve for a time under two administrations, and then that trend was broken.

But if we are to have to deal with this huge budget and this huge debt, we must give greater attention to competence in our national government, all along the line. That means that we as citizens must be readier to direct our own sons and daughters into the service of the government and not leave such service to anybody who may come along; that we cannot shun politics and turn our back on it because it is a "dirty business". There is no single answer. I think we must pay higher salaries to our high-grade civil servants in that middle layer and give them better pensions and more honors. The knighthoods and the orders that they have in England have been a very helpful thing in stimulating public service. I do not advocate that we adopt that in this country, but I do think we need somehow to find the equivalent for our public servants.

These steps, which I have outlined, are essential parts of the program for dealing with the debt: to control the budget, to reduce the budget, to distribute the debt, to reduce taxes, to unfreeze interest rates, and to improve the quality of government.

The American people are more conscious of the problem than ever before. I do believe that if we take some intelligent action on these fronts, we can restore and carry forward the American system of free enterprise.

REMARKS BY THE CHAIRMAN

CHAIRMAN MORGAN: Thank you, Dr. Burgess! You have just listened to a broad survey of a complicated and difficult question. It was done with clarity and, as we all expected, with persuasiveness.

In Washington is the Brookings Institution. It is not only an institution for economic research; it is an institution for the examination and formulation of policies. In that way, it serves a very useful function.

An important member of its staff, Dr. A. D. H. Kaplan, is our next speaker. Dr. Kaplan is a native-born son of the state of Colorado. Recently he has been working with the Committee on Economic Development, at the head of a staff preparing a monograph on the financing of small business, a topic closely related to that which has been assigned to him for our meeting this morning—"The Rôle of Small Business and Free Enterprise". Dr. A. D. H. Kaplan!

THE ROLE OF SMALL BUSINESS AND FREE ENTERPRISE

A. D. H. KAPLAN

Brookings Institution, Washington, D. C.

THE framers of this program of the Academy are evidently a practical committee who do not ask for the impossible.

At least, no one has been given the assignment of defining "free enterprise". The enterprising editors of the unabridged Webster have taken more than a page to explain the term "free". They have defined it with its combinations, from "a" represented by *free air* to "w" with *free wheeling* and *free will*; but they avoided even the mention of *free enterprise*.

A comforting quality of our understanding of the term free enterprise is the freedom that has been assumed in changing the definition of the term to suit the time and the particular interests that are involved.

In the progress of a social order it is axiomatic that as the society becomes larger and more complicated and more congested, the exercise of freedom becomes increasingly tied up with the question: "How will my exercise of freedom affect the liberty of action of my neighbor?" At every place in the market where elbows are rubbed, there develops an urge to set a rule or standard whereby transactions may be effected with a minimum of mutual annoyance. Whether the protection from annoyance to one is at the expense of another—who is defended against whom and what innocent bystanders, competitors and consumers are drawn into or crowded out of the net of regulations—becomes ultimately a matter of public concern, for the general welfare.

As the rules of the game multiply and as the rules made in one sector of the market clash with those adjacent, we run into the problem of coördination and trade-practice codes and eventual centralization of authority. The struggle to avoid the rigidity of centralization, with its consequent sublimation of individual initiative and self-reliance, vies with the struggle to avoid the disorder of undisciplined individual actions.

Applying the generalizations to small business, we are concerned with the opportunity of the small enterprise to function competitively within a mass production economy, and to the rôle of government in making that feasible. It is the business of government, as arbiter, to resolve specific conflicts of individual or group interest in terms of what is conceived to be a fair market. In more positive ways it is the rôle of government to help create an economic climate in which small business may thrive and make its maximum contribution to the progress and vitality of the whole economy.

"Small business" is as elusive a term as "free enterprise". Any line of demarcation drawn between small and big business will include some that are large enough to have big business characteristics, and it will exclude a number which, while physically large, have the problems of a small business in relation to the giants that surround them.

There are at present approximately $3\frac{1}{2}$ million private business firms outside of agriculture. They vary widely in their outlook as well as in size. If we include under small business all enterprises with 100 or fewer employees, then *all* but 26,000 firms, or more than 99 per cent, are within the area of small business. If we consider the firm with 100 to 500 employees as being in the intermediate class, then not more than 5,000 enterprises qualify as big business—less than $\frac{1}{7}$ of 1 per cent of the business population. But those 5,000 companies employ nearly 40 per cent of the 40 million persons engaged in non-farm business. They wield an industrial influence far greater than that of the $2\frac{3}{4}$ million little firms with three or less employees, which crowd the bottom of the scale.

Apart from the volume of wealth and employment it creates, the prime significance of small business for the continuance of our free society is that it represents more than three million centers of initiative. It means more than three million centers of economic responsibility, of incubation for productive ideas, of competition for the opportunity to satisfy the wants of consumers and progressively raise our standard of living. The recent history of the totalitarian states furnishes us with the evidence, if that be at all necessary, that the elimination of democracy and the elimination of independent small business go together.

We do not have to dwell here on the notable contributions that have been made to the economic primacy of our country through mass production. In its wake have come the far-flung problems of management that go with big business and impinge on small businesses.

Small business has inevitably been drawn into the orbit of large-scale enterprise. Affiliated with the large manufacturer are dealer agencies which distribute and service the products that come off the assembly line. Other small units operate under more or less exclusive agreements for the handling of national brands. Small enterprises conform to basing points, zone pricing and resale price maintenance. The small firm competes with the integrated corporation which at one level is its supplier and licensor, and at another level is its competitor. Small business has had to find ways to offset the advantages of large-scale enterprise in technical research, managerial talent, in buying power, and advertising prestige. It has had to contend with a trend of investment capital toward the large enterprise and the stability that the large corporation symbolizes in the popular mind. It must also live with big labor, as a counterpart of big business.

In the face of these developments small business has continued to replenish its ranks, to survive and grow. The percentage of small enterprises in the total population has remained fairly constant over the years. The net loss of half a million firms during the war was more than made up in the last eighteen months. Big business, indeed, has paved the way for many new forms of small enterprise even as it has displaced others. The record is a tribute to the hardiness of small business; it is evidence that small and large businesses can operate side by side and maintain the essentials of an economy of competitive enterprise. But despite a continual enlargement of the rôle of government as rule maker and peacemaker, to keep open the lanes of competitive opportunity, small business faces serious handicaps to its continuing survival and growth. It suffers shortcomings in management, and in certain areas of financing. It also has an unending struggle for equality of competitive opportunity.

Management Guidance

The studies of business failures and the testimony of those who best know small business leave little doubt that the caliber

of the management is the most decisive single element in the success or failure of the small enterprise. The high potential of post-war competition, the large number of new businesses established since the end of the war, and the market instabilities characteristically following a war, all combine to make the management guidance of small enterprise a crucial factor in its weathering of the years ahead. Competent outside guidance for the small business—whether in financial self-appraisal, market development, or technological research—is not readily available to the small business on an individual basis, at a price that it can afford. There is room for a fruitful expansion of the activities of suppliers, banks, and trade associations and schools of business in furnishing management guidance to small enterprise. Business ownership as a career needs emphasis in the collegiate schools of business.

The government has a legitimate rôle to fill as educator in the management of small as well as large business. The government is the leading collector of data on the character of the population, on income and its distribution, prices and production, all of which represent basic information for market analysis. Through the Bureau of Standards and other research agencies the federal government has contributed to the technical guidance of the small business which lacks the resources for its own technological development and research. The government agencies can extend the practical value of their research by adapting it to the needs of small enterprises, directly as well as through trade groups and institutions of business education.

Financial Aid

Currently the small business finds short-term credit available and ample. There has been evidence also of a trend toward longer-term credit to small business for working capital, with the blessing of the Federal Reserve System and the bank examiners. The more fundamental unsatisfied need is for permanent, risk capital to be made available to small enterprise.

The progressive urbanization of our population, with its concentration in metropolitan centers, has resulted in a decline of the relative importance of personal acquaintance and kinship as a basis for investment and financial support of new ventures. The increased fraction of earnings distributed as taxes has slowed

down the rate at which profits may be plowed back into the business. It has also reduced the individual savings available for risk capital. The flotation of securities by the small business has proved prohibitive in cost and has had, in general, poor market reception. Moreover, the small-business man is characteristically reluctant to obtain new capital at the price of losing his control as owner-manager. All of these factors point to the necessity for some new means of providing permanent capital for the small and growing enterprise.

There have been spasmodic attempts to supply business capital through private civic bodies like the Industrial Development Corporation and local foundations for attracting enterprises to the community. The Investment Bankers' Association presented a plan about two years ago for the establishment of investment houses to cater especially to the needs of small business. But it is obvious that these efforts have barely scratched the surface of the problem, and would hardly meet the requirements of the really small enterprise.

The need for small-business capital has been recognized in Congress by the introduction of a number of bills looking toward the development of a government investment and lending agency which will continue, on a permanent peacetime basis, the financial support given to small business during the war through the Reconstruction Finance Corporation and the Smaller War Plants Corporation. Legislation along this line has not yet been enacted. For the moment, small business feels prosperous, and is not pressing for additional financial aid. The demand for government financial aid will undoubtedly be intensified when business activity slackens. It has sobering implications. A government investment agency, if launched, would undoubtedly be called upon to do the more liberal lending which private sources regarded as relatively unsafe. Particularly in the event of a depression, the government would find itself with a considerable number of defaulted small enterprises in its lap; the resultant political pressure would probably call for additional funds rather than the liquidation of unsound and inefficient enterprises. The prospect is hardly conducive to efficient, vigorous, small business.

The source to which the small-business man naturally comes for his credit is the bank in which he deposits his funds. It is

to the banking system itself, therefore, that we should look for an extension of its services that will include the capital requirements as well as the short-term credit needs of the small enterprise. The commercial bank is generally not attuned to the supplying of permanent capital. It demands liquidity for the protection of its depositors and its tradition is out of keeping with the sharing of the risks involved in equity capital. The commercial bank should have a suitable outlet to which to refer its customers who require permanent capital. A logical supplement to the present banking system would be a system of capital banks created under charter and supervision of the Federal Reserve System, and devoted exclusively to the supplying of equity capital for the small business. The stock of the capital bank could be subscribed by the member banks up to, let us say, three per cent of their risk capital and surplus. There would be no objection, once such a bank got started, to the inclusion of outside individual subscription. Such a bank would finance a capital program for the small enterprise on the security of debt paper, bonds, preferred stock or common stock. The ultimate control of his business could be insured to the small enterpriser by a redemption feature under which the borrower reserved the privilege of buying back his stock within a liberal time limit. While the capital bank was holding the stock, it would share in the profits of the firm, commensurate with the risk. Management-guidance services would need to be provided as protection in connection with such long-term financing to small business. An important longer objective of such facility would be to develop new techniques adapted to the peculiar requirements of the small business.

There is, of course, no adequate substitute for the sound growth of a small enterprise that develops from the plowing back of earnings. This fact must come to be recognized in the revision of the income tax.

Competitive Opportunity

The most pervasive relationship of the government to business lies in the area of competition and its protection. The struggle for market advantage is continuously, necessarily, going on. In the original anti-trust acts designed to prevent the restraint of competition, it was assumed that what small business wanted

most was to keep competition free and untrammelled; but the issue between small and large business is not nearly so clear when fair competition and unfair competition have to be spelled out. The record of recent years indicates that most of the concerted effort of small business has been to regulate competition so as to define the limits within which it may be carried on. The fair-trade codes prevailing in nearly all of the states protect the right of the manufacturer to determine the minimum resale price of his product, and to make all sellers conform; they have sought to protect profit margins; they have imposed progressive taxation on chain-store units to check their growth. Punitive license measures have been invoked to limit the entry of newcomers into various lines of business. Interstate barriers have been imposed in the form of prohibitive licenses or under the guise of public health or true grading measures. These devices have given rise to subterfuges and counterattacks. Few of them have been successful in their original objectives but they have succeeded in achieving a contraction of economic opportunity. The protection of the small enterprise from abuses of economic power or from unethical practices is a problem of continuing administrative oversight and adjustment.

It is not surprising that in the multiplicity of efforts to regulate the complex competitive structure, inconsistencies have developed in the legislation on competitive practices. The Sherman Anti-Trust Act was intended to keep competition free and open. The Clayton Act placed prohibitions upon interlocking directorates and collusive action in restraint of trade. But in recent years the Clayton Act has had two important amendments. Under the Miller-Tydings amendment the federal government gives its sanction to resale price maintenance and to similar measures in state laws, which regulate price competition on commodities. The Robinson-Patman Act limits the degree of differentiation that may be made in the terms given to various classes of customers. The Federal Trade Commission, in its efforts to keep the lanes of competition open while discouraging unethical competitive practices, finds itself hampered by the multiplicity of state laws in restraint of competition. An additional embarrassment of the Federal Trade Commission is the fact that small business groups have themselves insisted upon many of these measures to limit the scope of competition.

Following the findings of the Temporary Economic Committee, which revealed the inconsistencies in our laws on trade practices and competition, it was hoped that the Congress would proceed to a reëxamination of and revision of our anti-trust legislation, in the light of the court decisions since the original anti-trust legislation was enacted and the experience of the Federal Trade Commission. The war intervened. But the time is overripe for a recasting of our anti-trust legislation into a consistent piece of legislation that will provide the basis for understanding and adequately enforcing the rules pertaining to competition and restraint of trade.

At the state level, there is even greater need of distinguishing between measures that preserve competitive equity and those that are restrictive of competitive business. Some progress has been made through the Council of State Governments and regional civic groups in the attack on interstate barriers that hamper enterprise and that often bear most heavily on small business. There lies ahead the important and difficult task of developing, from the analysis of the state fair-trade laws, a body of guiding principles and codes that are not primarily the work of special interest groups, but represent a disinterested regard for the maintenance of a competitive economy in which there is equality of opportunity to offer one's goods and services on their merit. The consumer's interest, for the long run as well as short run, must be recognized in the final judgment of what is fair-trade practice.

When we speak of independent small business we speak, of course, in relative terms. Every small business is under the necessity of adjusting itself to the disciplines imposed by government regulations, mainly for its own protection. It must also meet the challenges that arise from new products and new methods of merchandising. Small business cannot and should not expect to be protected from the necessity of competing for the favor of the consumer as the latter exercises his choice of products and services. The small-business man may, in some areas, have to join his fellow enterprisers in building up buying power, in developing competitive brands, in group advertising and promotion, in order to hold his own. He who seeks profits must be prepared to bear risks.

But when this much has been said, there remains the interest of a democracy in keeping the gates of opportunity open to the small independent enterprise. When the small enterpriser is crowded out of the market because he is squeezed both vertically and horizontally by the integrated producer or chain, private enterprise as a whole is endangered. There is no public chorus to sing "Big Business, we love you." If there were, it might consist of those who would welcome the concentration of business because in their political philosophy it is a step toward eventual nationalization of industry. Only as millions of small enterprises may operate economically and efficiently may the continuance of private enterprise, with its visible advantages over totalitarian economic systems, be assured.

REMARKS

CHAIRMAN MORGAN: Thank you, Dr. Kaplan! That was a most instructive address.

The final speaker on this morning's program is well known to the members of the Academy. He has been a friend of the Academy for many years. He is a professor at Columbia and is a member of an impressive firm of lawyers. He is engaged in good works of many sorts, trusteeships and other unremunerated services. He was formerly Under Secretary of the Treasury. As an authority on taxes, I think he is second to none in the United States. In any case, when anyone is in difficulty in understanding what the tax laws are, he is apt to turn to Roswell Magill. Mr. Magill!

MR. ROSWELL MAGILL: Mr. Chairman, Ladies and Gentlemen: I wonder if you appreciate how much difficulty you and I are in. First of all, Dr. Burgess has suggested to you that you wander out of the room as promptly as possible. As the noon hour is approaching, I shall be speaking to the last unfortunate members of the procession. That is bad enough as a forecast; but Dr. Burgess went even further. For some reason, not particularly caring for his own topic this morning, he spent his time speaking on mine. Like Coleridge's Ancient Mariner, I had equipped myself with an albatross in the form of a prepared address, one of those horrible things that people read to you. What am I to do now? Should I throw this elegant and well-worded address into the discard, look you in the eye and talk to you on the subject of debt and free enterprise, or should I just say, "Well, it's a sad situation for both of us, but we'll have to make the best of it"?

As I sat here, perspiring mightily and feeling very unhappy, along came Dr. Kaplan. I had hoped to obtain your consent to a change in this somewhat Dale Carnegiesque topic which I am to speak on here—whoever devised that topic had been educated in the participle to an alarming degree—and I had thought that perhaps it could be simplified to such a label as "Taxation for Free Enterprise". I would even agree to substituting "Taxation and Free Enterprise", if anyone wished. But Dr. Kaplan comes along and, in the words of one of my former instructors, says that such a topic would be perfectly true, perfectly general and perfectly meaningless.

Therefore, having suffered now from the two preceding speakers in an attack, first, upon my chosen topic, and then upon the subject matter of my address, I stand here confused, and I obviously must ask your sympathetic assistance in what is going to be an unhappy occasion for both of us. Here it comes!

TAXATION FOR FREE ENTERPRISE

ROSWELL MAGILL

Former Under Secretary of the Treasury

NO one can doubt that the successful completion of World War II marked the beginning of a new era for the United States, in domestic as well as in international affairs. Every day we see evidence of our new and increasing responsibilities abroad. Our domestic situation has also greatly changed since the thirties, notably in the fiscal field. We went into the war with a federal debt of \$55 billions, which was more than any of us could understand; we came out with a debt of nearly \$270 billions. The federal government collected nearly \$19 billions in individual income taxes in fiscal 1946, as compared with about \$1 billion in 1939. In 1940 the individual with an income of \$3,000, married with two minor children, paid no federal income taxes and the individual with \$100,000 paid \$33,128 in such taxes. In 1946, the \$3,000 man paid \$133 and the \$100,000 man paid \$54,093. An increase of such magnitude not only spells heavy federal tax burdens on individuals; its impact spells significant changes in standards of living and ways of life, as we all know.

This morning's program is limited to a few vital domestic problems. My remarks will not change that orientation, for taxation, too, is primarily a domestic concern. The very proposed title of my address shows further that I accept the philosophy of the previous speakers: that the free private-enterprise system has proved to be the best system for our economy, and that we should preserve it by giving it a fair chance to work. Misdirected taxation, not merely the sheer burden of taxation, is perhaps the greatest threat to the free-enterprise system in this country today.

1. *The Federal Budget*

You are all reasonably familiar with the basic fiscal facts, and I shall therefore try not to bore you with needless figures.

The President proposed a budget of \$37.5 billions of expenditures for fiscal 1948, the fiscal year starting July 1, 1947. If present business activity is maintained, and if all our present taxes were maintained at present levels, estimated federal receipts from taxes and other sources in fiscal 1948, as the Budget Bureau estimated them, would exceed estimated expenditures by a little over \$1 billion. Most of this surplus is attributable to the reënactment on a permanent basis of wartime sales and excise taxes, which otherwise would have expired on June 30.

The budgetary surplus, thus, is not very great. True, our federal financial condition will be the best it has been for many long years, for we have had annual budget deficits every year since 1930. But it is prudent to bear in mind that a balanced budget has been obtained only by the application of the highest peacetime tax rates we have ever known to the highest national income we have ever had. Should our national income retreat to the level that the Budget Bureau used in its estimates only a year ago, the President's budget would be \$10 billions out of balance.

Hence the first great question being debated in Washington today is whether federal expenditures can be reduced, so as to permit a substantial payment on the public debt, and some reduction in taxes. There seems to be general agreement among Republicans and Democrats alike that the budget at long last must be balanced. To my mind, that proposition is pretty clear. If we cannot balance the budget in a year of great business activity and full employment, when can we balance it?

The next question, whether proposed federal expenditures can be reduced by \$4, \$5, or \$6 billions, is one which must be dealt with either in a thick volume of data on the necessity for and the cost of each government activity; or in a page of conclusions from a few basic facts.

For this occasion, the latter will be enough. We can afford the President's budget only if we feel sure that very high business activity can be maintained indefinitely; and further, if we are willing to continue to bear the full burden of World War II tax rates. Unless those two factors persist—very high business activity and very high tax rates—a federal budget of \$37.5 billions cannot be balanced. Hence, in my view, federal

expenditures must be reduced, and competent students believe it can be done.

Federal expenditures, three years after the war, are still several times the \$3.2 to \$9.7 billions range of the thirties. There are still too many government employees in too many bureaus and departments. The vast sprawling mass of federal activities has still not been fully trimmed down from the free-spending days of the war. The year 1948 will not be, I am afraid, the "normal post-war year" of our hopes. There must be greater expenditures for international relief, for the Army and Navy, for the veterans, than will be required hereafter. Even so, the budget should be brought down in 1948 to around \$32 billions, and in succeeding years to \$20-\$25 billions. One good way to promote business confidence and venturesomeness and to alleviate everyone's fear of a recession is for Congress to make it clear that the federal budget is really under control; that the federal government is going to try to get \$1 value for \$1 spent; that federal taxes, though they will need to be high, will not have to be truly astronomical.

2. Federal Taxes

The premises on which the federal tax system should be based are more important than the detailed rates, exemptions and substantive provisions.

First of all, what part should tax statutes play in our scheme of things? Everyone recognizes that taxes, particularly individual income taxes, of the magnitude we have now, and shall have throughout the foreseeable future, play a major part in shaping business decisions. It follows that the impact of taxes upon our economy deserves careful study, in order that our taxation policies may be shaped to serve the same governmental or economic ends that our other national policies do. If we believe in free private enterprise, our tax system should be framed to permit free private enterprise to function and flourish for the general good.

This is not to say, however, that taxation should be directed primarily to enforce social or economic policies deemed desirable at the moment. The primary utility of tax laws is to raise money fairly to meet the expenses of government. That is the target at which the shotgun of taxes should be aimed. It is a

difficult target to hit, even with a shotgun. It is hard enough to draft laws that will raise billions of revenue fairly from all sorts and conditions of businesses and men, without undertaking, at the same time, to accomplish desired social or economic ends. If such changes are to be made, let them be accomplished openly and plainly by a statute drawn for the purpose, not brought about by indirection in a revenue act.

Our fundamental premise is that the free private-enterprise system should be maintained. What makes it go? Primarily the vigor and the enterprise and the competition of the men who manage it. Do not forget that, however great our corporations may become, they will be and must be managed by men. Any new capital, not developed by the business itself, will have to come from men. If, therefore, we are primarily concerned with the maintenance and progress of the free-enterprise system, it is the impact of the individual income tax upon the managers and the stockholders of American business that requires our first attention.

Gallup polls have revealed that the man in the street underestimates by a surprising margin the income taxes payable by an American business man today. The fact is that the tax rate exceeds 50 per cent on all income earned in excess of \$18,000. That is, once a man reaches an income of \$18,000 or more, the United States Treasury is entitled to more than he is himself of every additional dollar he can earn. Once he reaches an income of \$44,000, the Treasury takes more than 68 cents out of every additional dollar he earns, leaving him 32 cents for his own work. If he can increase his income to \$70,000, the Treasury takes more than 77 cents out of every additional dollar he earns, leaving him 23 cents to compensate for his own labor. Does anyone believe that surtax rates of this sort are more likely to induce men to take on additional responsibilities; or to persuade them to take a rest? With the present federal budget, and the budgets we are bound to confront for a good many years to come, the Treasury has too great an interest in these men's activities to afford to encourage them toward a life of leisure.

It may be said that these salaries are the salaries of successful men, and that most men do not enjoy such incomes. To be sure, they are; but are not the managers of American corpora-

tions typically men with incomes of these amounts or more? Indeed, at the present time, an \$18,000 salary is not notably high, and many men well below the top rank of American executives receive that and more. Another point is that my examples state the tax on the next dollar of income earned by men with the respective salaries, and that the effective rate of tax on the total salary is not so great. Here is a table showing the take-home pay (income after federal taxes) at different income levels:

TAKE-HOME PAY (AFTER FEDERAL INCOME TAXES) AT VARIOUS
GROSS INCOMES * IN 1930, 1940, 1946

Single Person

<i>Gross Income</i>	<i>1930</i>	<i>1940</i>	<i>1946</i>
\$3,000	\$2,986.50	\$2,934.80	\$2,578.20
5,000	4,966.25	4,870.00	4,202.00
10,000	9,876.25	9,492.00	7,976.50
20,000	19,441.25	18,052.00	14,347.50
50,000	46,206.25	38,828.00	28,283.00
100,000	86,556.25	65,732.00	44,710.00
200,000	164,156.25	109,588.00	68,548.50

Married Man with Two Dependent Children

3,000	3,000.00	3,000.00	2,867.00
5,000	4,997.75	4,950.00	4,515.50
10,000	9,939.25	9,696.00	8,423.00
20,000	19,546.25	18,468.00	15,060.00
50,000	46,311.25	39,636.00	29,280.50
100,000	86,661.25	66,872.00	45,907.00
200,000	164,261.25	110,868.00	69,831.00

* 10 per cent allowed as deduction from gross income.

What these figures show is that steep increases in individual income taxes have occurred in the middle and the upper brackets. Hence, if income taxes are to be reduced, there are two substantial reasons for reducing surtax rates in the upper and middle brackets. First, the incomes of the men who manage American business fall in those brackets, and we want to encourage them as much as we can to vigorous activity in the next decade. Second, since the wartime increases in tax rates were sharpest in those brackets, in fairness they should be given priority in tax reduction after the war.

But Congress should do more. It is also true that the base of the income tax has been materially broadened through the lowering of exemptions. The bulk of taxable income and of taxpayers are in the middle and the lower income brackets. Hence, it is not possible to raise *exemptions* much without too great a loss of revenue. If expenditures can be reduced, however, *rates* in the lower brackets can be somewhat reduced, and they should be. So long as the individual income tax is relied upon to raise approximately half ¹ the federal budget, as it must be, the initial rates of the income tax cannot be very greatly reduced; but it is possible to give all taxpayers a percentage reduction.

The key to the whole problem of tax relief is the level of expenditures of the federal government. If budget expenditures can be brought down \$4 billions or \$5 billions or \$6 billions, individual income taxes can be reduced and a substantial payment can be made on the debt as well. Since Congress probably will not undertake this year a revision of the whole normal tax and surtax rate schedule, the fairest procedure for tax reduction seems to be a straight across-the-board percentage cut, and the House of Representatives has proposed such a cut. If this is done, the progressive rate structure is left in effect, with a pro rata reduction. Every taxpayer benefits, to the extent that he has been paying taxes. The big taxpayer gets more benefit than the small taxpayer, but only because the taxes he has been paying are many times as great both in rates and amounts.

3. *The Next Step*

Reduction of federal expenditures and of federal taxes by several billions will be a major fiscal accomplishment, but a great deal will still remain to be done. There has not been a thorough revision of the substantive provisions of the federal revenue laws since 1942. In the meantime, a number of sections of the law have been found to work badly, and there have been a number of court decisions that need correction. For example, amendments to the statute are needed to clarify the

¹ The individual income tax produced \$18.26 billions in 1944; \$19.034 billions in 1945; and \$18.331 billions in 1946. The budget estimate for 1947 is \$17.967 billions and for 1948, \$18.391 billions.

treatment of family trusts; the issuance to officers and employees of options to buy corporate stock; and the retention of corporate earnings for the needs of the business. The treatment in the estate tax of trusts in which the settlor has retained some remote or contingent reversionary interest, and of insurance in which the insured has retained no interest, is wrong in theory and works badly in practice. The Secretary of the Treasury listed to the Ways and Means Committee last month a dozen other topics on which the Department has been working for years, and is prepared to make recommendations.

The method for a thorough revision of the revenue laws, which is usually popularly proposed, is for someone to appoint a distinguished committee. But a really distinguished committee is not easy to secure; and even if it is secured, and actually reports, its views are not likely to be heeded.

Moreover, there have already been published a number of reports containing recommendations of major changes. The task now is to put the recommendations into statutory form for actual adoption. The federal Constitution provides that revenue bills shall originate in the House of Representatives, and so they do. In practical fact, they originate in the Ways and Means Committee, after an initial period of labor by the excellent staff of the Joint Committee on Internal Revenue Taxation. The amount of essential staff work that must be performed is far greater than the public realizes.

The most successful revenue bills have been the product of joint work by a subcommittee of the Committee on Ways and Means and its staff with the coöperation of the technical staff of the Treasury. Such a joint effort should be undertaken this summer, to get a bill ready for enactment next year. A subcommittee of this character can do much more effective work than any outside group could possibly accomplish. It has a great amount of data and of technical assistance at its command. Most important, the Congressional members of such a group have been elected by the people; and by their membership on the Ways and Means Committee are charged with actual responsibility for revenue legislation. They can do a good job, and they often have. It is proof enough to note that the present Chief Justice of the United States made an early reputation as the chairman of just such a subcommittee.

Fiscal problems are bound to haunt us for years to come. Taxes will necessarily remain high. The federal government will continue to be the senior partner in every business and profession. It behooves us, therefore, to use our best brains on the tax system under which we must live and move and have our being. We must try to shape it so that, burdensome as it will be, it still permits, and indeed encourages, American enterprise to function and to flourish. The task is not easy in a complex and disordered civilization, but it can be done if Congress and the people see the issues and meet them squarely. I hope that here, as in the scientific fields, it will be possible to say that, if an American really understands a problem, he is well on his way to its solution.

REMARKS BY THE CHAIRMAN

CHAIRMAN MORGAN: Thank you, Mr. Magill! I am very glad that the indulgence of the meeting permitted Mr. Magill to go ahead and deliver his speech. I would say that it was a very profitable experience for us all.

[Because of limitations of space, the discussion from the floor under the five-minute rule at the morning and afternoon sessions has been omitted from these PROCEEDINGS.—Ed.]

PART II

LIBERATING INTERNATIONAL TRADE

INTRODUCTION *

RUSSELL C. LEFFINGWELL, *Presiding*

Chairman of the Executive Committee, J. P. Morgan & Co., Incorporated

LADIES and Gentlemen: This afternoon we have a most interesting topic and one of vital importance to all of us: "Liberating International Trade".

The first sub-topic is "International Trade with Planned Economies", and the speaker on that subject is a professor at Harvard, Dean of the Graduate School of Business Administration. He is also Vice-President of the Federal Reserve Bank of New York, and a learned and a wise man. I have the pleasure of introducing to you Dr. John H. Williams!

* Opening remarks at the Second Session of the Semi-Annual Meeting.

INTERNATIONAL TRADE WITH PLANNED ECONOMIES: THE ITO CHARTER

JOHN H. WILLIAMS

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I

WHEN I last spoke on this program, in April 1945, our subject was the Bretton Woods agreements. As we meet today, the representatives of our country, England, and sixteen other countries are meeting in Geneva for the dual purpose of agreeing upon a final draft of an ITO Charter for presentation to a world conference on trade and employment at some later date, and of making tariff concessions among themselves. The Monetary Fund, the World Bank, the International Trade Organization and its Charter, and the current tariff negotiations are all parts of a general plan, dating back at least to 1943, for restoring multilateral trade in the post-war world and reducing, so far as possible, the restrictive trade and monetary practices which in the inter-war period increasingly threatened to destroy the multilateral system.

I think I should say at the outset that in my discussion two years ago, as well as in earlier papers, I favored the International Bank but had some reservations about the Monetary Fund. Apart from technical questions about the mechanics of the Fund and the principles of international monetary adjustment, my doubts had to do mainly with the question whether in our pre-occupation with a long-run monetary plan we might not fail to deal adequately with the concrete problems of the transition period; and, in particular, whether in this over-all approach we might not fail to recognize that the interconvertibility of the dollar and the pound is the inner core of the monetary problem and that its achievement would have to depend upon the measures taken, outside the Fund and the Bank, to correct the British balance of payments difficulties.

Perhaps the largest question about the success of our efforts to restore a multilateral trade and currency system is whether we have not made a major, and possibly an irreparable, mistake in not dealing sooner with the British problem. By the time we got to the Anglo-American loan negotiations in the last half of 1945, much of the spirit of wartime coöperation had been lost, and the solution arrived at was, in my opinion, inadequate for the problem. We should have made a gift rather than a loan—perhaps at an earlier date we could have agreed upon a post-war extension of Lend-Lease. But if it had to be a loan it should have been interest-free. Britain's problem today is how to increase her exports by seventy-five per cent beyond their pre-war volume while restricting imports to their pre-war level. It seems increasingly clear that the loan will be used up before the end of the five-year breathing period that it was intended to finance; and if by 1952 the British balance of payments deficit is not corrected, and with enough margin to begin payments on the loan, it seems idle to expect that our efforts to restore a multilateral system of trade and currency can be successful.¹

One other comment on the Monetary Fund seems relevant to our current discussions of the International Trade Organization and its Charter. One point I strongly emphasized was that the Monetary Fund should not be used in the transition period, before the more normal trade conditions which its logic assumes had been realized. Thus far, no use has been made of the Fund, but in accordance with its provisions the member countries have declared their official parities; and with the general condition of inflation existing in the world, there has been an understandable tendency to overvalue relative to the dollar. Whether any such development was contemplated by the authors of the Fund agreement, whether, in dealing with such a large-scale problem of fundamental readjustments of rates as we may face after the inflationary conditions have passed, the Fund will be able to avoid another vicious circle of currency depreciations such as occurred in the inter-war period, and whether it might not have

¹ The most serious aspect of the British problem is not whether in the transition period she will be able to correct her balance of payments deficit with the aid of the loan, difficult though that problem is, but whether in the long run she will be able to maintain the new equilibrium required by her changed international position, including repayment of the loan. This is primarily a question of productivity and real income. See below, pp. 43-44.

been better to postpone the whole matter of official parities until more normal trade conditions have been achieved are among the larger questions for the future.

But one question which seems to be emerging with increasing definiteness, and which the premature declarations of parities may have helped to emphasize, is whether countries may not in future rely mainly upon direct trade controls and use them as a means of avoiding changes in exchange rates. There was already a tendency in this direction before the war, and war and post-war experience may have pushed it further. It may well be that the general pattern of adjustment technique will be one of trade restrictions first, exchange controls second, and exchange-rate variation third. Exchange control over capital movements is already provided for in the Fund agreement, but the intention is to do away with exchange control over current transactions, and the Anglo-American loan agreement provides for the freeing of British current transactions from exchange control by July 15 of this year. But in the discussions of the Bretton Woods agreements in England and elsewhere much was made of the fact that the monetary agreement did not cover trade restrictions and that there was still the possibility of accomplishing through direct import controls whatever the member countries might seem to be giving up in the way of monetary controls. It is not surprising therefore that the ITO discussions have provided the real field for debate as to the reservations on which countries will insist before committing themselves to any plan for the restoration of multilateral trade.

II

Throughout the post-war trade and monetary discussions there has been a common pattern of differences of national attitudes, the United States attempting to lead the way toward multilateral trade and reasonably stable and convertible currencies and the other nations endeavoring to safeguard themselves against the possible hazards involved. The ITO Charter has gone through several drafts since it was first drawn up by our State Department.² It was considerably revised at the first meeting of the Preparatory Committee last fall in London and

² *Proposals for Expansion of World Trade and Employment*, November 1945. These proposals developed out of the discussions leading to the British loan agreement, and were accepted in principle by the British government.

doubtless will be further modified at Geneva. This has been a continuous process of relaxing the logic of the multilateral system in order to gain wider adherence. The number and variety of "escape clauses" have increased. One of the most fundamental is the right to protect foreign exchange reserves by direct import trade restrictions. To this are related the reservation, much insisted upon, of protecting the home economy against external deflations—I see no reason why protection from external inflations should not equally be emphasized—and the reservation of a large degree of freedom to deal with economic fluctuations at home and to protect a country's internal economic planning.

One interesting difference between the Fund agreement and the ITO Charter is in the nature and degree of the authority assigned to the two institutions. Whereas, in the Fund agreement, the Fund must be consulted and must give its consent before there can be any resort, after the transition period, to exchange control over current transactions (for example, in the scarce currency provision) or before a member country can change its exchange rate beyond an initial ten per cent, in the ITO Charter the individual member country may suspend a number of major Charter obligations if, on its own appraisal, it considers certain criteria of economic strain specified in the Charter to have been fulfilled; in invoking such escape clauses the member need not even consult in advance with the ITO, which can, it seems, only review the case and approve requests for retaliatory action by other nations if deemed justifiable.

The Charter has been criticized as being merely a collection of escape clauses. Besides those I have mentioned, there are clauses which permit considerable latitude with regard to international commodity agreements, bulk buying by the state, domestic subsidies, protection of young industries, particularly in undeveloped countries, protection of a country's right to decide what imports are desirable and what are not, and so on. On such grounds, the Charter has been described as representing merely an official sanctioning of the restrictive practices of the thirties, and perhaps some new ones, whereas its main purpose before being subjected to international negotiation had been substantially to reduce such practices.

Such criticism, it seems to me, does not penetrate very deeply into the nature of the problem. Without denying that we may

too readily concede too much, we have to recognize that under the conditions now existing in the world it is a choice between this kind of approach and none at all. In criticizing escape clauses, we must not overlook the fact that we have our own. The President has found it desirable to assure Congress that any trade concessions to which we might now agree in Geneva will be withdrawn if they injure any American industry.

III

Much of this is by now familiar ground. We are brought back always, whether we are discussing the trade aspects or the monetary aspects, to the fundamental nature of the problem of international adjustments in the modern world, and to a recognition of how much more complex a world it has become since the English classical economists handed on to us the theory and the system of free multilateral trade and its monetary complement, the gold standard. That system assumed not only external freedom of trade at stable exchange rates but also, internally, a *laissez-faire* private-enterprise system. Through the free interplay of economic changes, working through the cost-price structures of the trading countries tied together through fixed exchange rates, the countries held each other automatically in balance in a balanced world. It was a beautiful conception, though oversimplified even for its own day.

I cannot in this short paper review adequately the changes in ideas or conditions, but four broad sets of facts must be emphasized.

1. The multilateral trade system developed out of the conditions of an expanding world in which different kinds of countries played complementary rôles, the manufactured products of the industrial countries being exchanged for the foods and raw materials of the less developed countries, the process being fostered by the flow of capital from the more to the less advanced countries, and the whole system revolving about England as the trade and financial center. In such a system, international trade adjustment was to a large extent a self-regulating process, and, to the extent that it was not, the mechanism of the London money market in normal circumstances provided such control as was needed. Even in the nineteenth century, however, the multilateral system was a fair-weather system, which broke down under conditions of war and of major booms and depres-

sions. But there was no room for doubt about its maximizing effect upon international trade and hence of the desirability of restoring it whenever it collapsed. Even before the First World War, there were indications that the system was undergoing change and that England was losing her central place. Now, as a consequence of two wars and the intervening maladjustments, we have a very different kind of world, and one of the basic questions is whether a substitute can be found to perform England's rôle of market of last resort and her rôle as creditor and controller of the international system.

2. The system never had the unqualified support of all the trading countries that its logic assumed. In the nineteenth century the main reservation was found in the unequal development of the trading countries and the case, strongly argued virtually everywhere except in free-trade England, for protection of young industries and young countries. But tariffs, though they modified the terms of trade and may at times have restricted its volume, did not interfere seriously with the multilateral system so long as England's large free market remained open.

3. The second great reservation upon the free working of the multilateral system has been the increasing emphasis upon internal stability at high employment. The maladjustments growing out of the First World War and the great depression of the early thirties have greatly increased this emphasis. Indeed, it seems not too much to say that, taken together with England's changed position in the world and the growing predominance of our own country in the grand aggregate of world production, these changes have completely altered our conception of the problem, to the point where we find ourselves compelled to recognize the dependence of order and stability in world trade upon the maintenance of stability at high employment in the leading countries, and particularly in this country. Some of the countries participating in the ITO discussions, notably Australia, have carried this changed viewpoint so far as to insist that adherence to a multilateral system must be conditioned on some kind of guarantee of stable high employment in the United States, the alternative being complete freedom to the other countries to set up regional or bilateral systems based on common policies to maintain high production and employment within the trade area, and to protect themselves against external disturbance.

4. To an increasing extent this reservation in favor of internal stability has been developing into what I think must be recognized as a third kind of reservation, namely, the right of a country to plan its economic and political system, even though this may mean nationalizing its industries and controlling its economy for purposes of social security and welfare, as well as business-cycle stability. Thus we have a very mixed world with countries ranging all the way from our own still predominantly private-enterprise system through various degrees of planned economy embracing elements of state socialism to a completely controlled economy like that of Communist Russia.

IV

Our problem is how to restore a multilateral trade system which was the product of the comparatively free economic world of the nineteenth century in such a world as this and make it work to the general advantage. It can be done, if at all, only by a process of evolution, and success will have to depend primarily upon what can be done, outside ITO and its Charter, to promote conditions favorable to such a process. We shall have to recognize that the task is essentially one of pioneering, of fitting an old technique to a new set of conditions, and that doctrinaire insistence on old principles and formulas is not the right approach. On the other hand, it seems no less true that much of what I have referred to above as reservations upon the free play of the multilateral system will have to be thought through anew to see what are the limits which external forces necessarily impose upon freedom of internal planning.

I have not now much confidence in the suggested formula that we can have the best of both worlds if only the nations will combine upon common domestic policies for maintaining high employment. Though I made such a suggestion regarding this country and England in my first paper on the Monetary Fund in 1943³ I was relying heavily on the intimate wartime coöperation we then had; I question now its feasibility even for these countries; and any general extension of the idea of common do-

³ "Currency Stabilization: The Keynes and White Plans", *Foreign Affairs*, July 1943. Reprinted in my book *Postwar Monetary Plans and Other Essays* (2nd ed., New York, 1945), ch. 1. See also R. G. Hawtrey, *Bretton Woods for Better or Worse* (London and New York, 1946), pp. 112-14.

mestic policies to a large number of countries in such a mixed world seems visionary. Hardly more practicable is the idea of a "guarantee" for continuing high employment by this country as the necessary condition for adoption of a multilateral system. We must indeed recognize the importance, for the problem, of stability here at home, and the reasonableness of escape clauses if this condition is not realized; but it will be unfortunate if our efforts at international trade and monetary coöperation degenerate into mutual reproaches such as this formula so readily suggests.

For the world at large the problem is one of finding the limits of tolerance which external conditions impose upon the freedom of internal action. In the inter-war period the international maladjustments and the great depression, combined with the development of "closed economy" economics, pushed to extravagant lengths, in my opinion, the analysis of currency depreciation, exchange control, and restrictive trade devices as buffers to protect the home economy and the freedom of internal policy. Now I think the pendulum is swinging back. The Second World War has uncovered the absurdity—which was always there—of supposing that nations ever really had a choice as between living in this world or in closed economies. But the swing back is only partial. It does not mean that other countries have given up, or should give up, their freedom to plan for internal stability and security. What is, I think, being forced upon us is a clearer recognition that such freedom can be exercised only within the limits imposed by a country's international position, by the extent to which its own well-being is dependent upon its relations with the outside world. Where the pendulum will come to rest, just what the nature of the ultimate compromise will be, no one can say. The swing in the British attitude has been striking, as between, for example, Lord Keynes's paper on "National Self-Sufficiency"⁴ in 1933 and his posthumous paper on "The Balance of Payments of the United States"⁵ in 1946, or the Chancellor of the Exchequer's recent statement that British policy is being dominated by the exigencies of her balance of payments position;⁶ and almost

⁴ *Yale Review*, vol. XXII, Summer 1933.

⁵ *The Economic Journal*, vol. LVI, June 1946.

⁶ *The New York Times*, April 17, 1947.

nothing now is being heard of currency depreciation as the way out. To a striking degree, the problem is being posed as the classical economists might have posed it, in terms of productivity and real income.

V

I have always insisted that international trade adjustment is a two-sided process. If for other countries the meaning of this is that external forces impose upon them limitations of productivity and real income which circumscribe their freedom of internal planning, what are the implications for ourselves?

I referred earlier to England's rôle in the nineteenth century. Our position in the world today is in some respects similar to England's former position, but in some respects it is different. We are not nearly so dependent on external trade. As our history has so often proved, in our mixed industrial-agricultural economy there is much more room for internal conflicts about external policy; and at the same time we are much freer from external restraints upon internal policy. Though multilateral trade is the natural and logical complement of our kind of economic system, we could dispense with its benefits more readily, in case of need, than almost any other country. It follows that whatever hazards there may be in restoring multilateral trade, should it not work well, would affect us less than almost any other country. At the same time, it is probably true that with our favorable trade-balance position, our lesser dependence on foreign trade, and our much greater freedom from controls in domestic trade, we are less well equipped than some other countries, and perhaps notably England, to play the game of bilateral bargains and restrictive trade practices if it should come to that.

It is not easy to say what these differences add up to, but it does seem true that if we are to play England's former rôle in the multilateral trade system, we must do it in a more conscious and deliberate way than ever she did. In the forefront of the problem is the need for maintaining stability at home. This, as I have said, has been much emphasized by other countries, and while it can be pushed too far and developed into a general alibi for bad behavior, it does seem true that the maintenance of high employment here at home is the greatest single contribution we can make toward the success of our own efforts to restore multilateral trade. But we are far from agreed among ourselves as

to how this can or should be done, and the most relevant and hopeful aspect of the matter is that, looking beyond the present inflation and its correction, we seem to have a good prospect of sustained high production and employment for some time ahead.

For our external policy there are both trade and financial implications, but a less clear prospect as to how matters will turn out. There is need—and this is where the contrast with England's earlier position seems to me sharpest—for a rather drastic reorientation of our outlook on foreign trade. We shall have to learn not to count upon exports for leverage to sustain high employment at home if such a policy means putting further pressure upon the already strained position of other countries. This is less a question of the volume of exports than of the export surplus. There will probably be a larger than normal demand for our goods and services for some time to come, but long continued one-sided trade can end only in the breakdown of the system we are striving to restore. For a proper balance in the world we must increasingly emphasize our imports. We saw during the inter-war period the evil consequences of a mechanical propping-up of our economy by one-sided trade involving either a draining from the rest of the world of its monetary resources or a foreign "investment" which did not give rise to a flow of goods from the borrowing countries.

But this is one of the thorniest aspects of the whole problem, and adequate discussion would run much beyond the limits of this paper. It seems certain that large-scale American financial aid will be essential over the next decade if we are to achieve the objectives of the International Trade Organization and its Charter. Already the total, mainly governmental, has been large. But the need ahead is probably greater in the aggregate than that to which we already are committed. How much it should be, how much of it should be raised from public and private sources, toward what purposes and what countries it should be directed, and how it should be administered are among the largest questions we shall have to face. We need much more knowledge as to how capital can effectively be spent abroad. We saw after the last war that foreign investments misdirected or badly administered are worse than none at all. We greatly need to develop improved standards and procedures and to differentiate more carefully between the kinds of expenditures that should be financed at home by the borrowing countries and those that should be financed from foreign funds.

So far as government aid is concerned, it seems already clear from our grant to Greece and Turkey that we shall not be able to stand merely upon the present commitments of the Export-Import Bank plus our participation in the Bank for Reconstruction and Development. In my earlier papers, I emphasized the need for stabilization loans, on the model of the League loans after the last war, loans which have a function lying somewhere between credits from the Monetary Fund and the Bank's specific projects for reconstruction and development, loans the purpose of which should be the general rehabilitation of distressed countries. Some such broad and even liberal definition of the task of reconstruction seems essential, even though it involves financial risks, if we are to live up to the logic of the International Trade Organization and restore the capacity of foreign countries to produce and export as rapidly as possible, and at minimum expense to standards of living already so depressed in many countries.

As I have said, our ultimate objective, if we are really to make the multilateral system work, must be the expansion of our imports relative to exports. Unfortunately, this is more than a question of reorienting our commercial policy, difficult though that is. In the background lies the much debated question of a chronic shortage of dollars, such as we had in the inter-war period, and of how much this was due not only to errors of policy on our part but to a cumulative productivity advantage by this country, combined with an abnormally strong foreign demand for our consumer durable goods and capital goods. Such a case of deep-seated and continuing disequilibrium was not regarded as possible in the classical theory of international trade, and foreign investment was always counted upon to bridge any temporary gap. In the inter-war period, however, capital movements were often perverse and intensified trade maladjustments.

Possibly this time, with capital movements from other countries subject to exchange control and our own to a large extent governmentally directed, foreign investment may come nearer to serving its true purpose, which should be to increase the capacity of the borrowing countries to export. But to alter our trade balance enough to overcome the dollar shortage problem may be a long drawn-out process. I find no comfort in Lord Keynes's suggestion in his last article that the United States is

becoming a "high-cost, high-living" country,⁷ by which I take it he meant that our need to import is increasing and our competitive ability to export decreasing. When I try to draw up on paper a list of the changes in imports and exports that might overcome our export surplus I have difficulty, and find myself wondering whether any theory of international trade adjustment is capable of providing a convincing answer. In any case, Keynes's reasoning seems not to fit the facts. Historically, "high living" in this country has been a reflection of high productivity; and the fact that during and since the war a great deal of capital has gone into American industry, while nationalization of British industries has been retarded, does not suggest any lessening of our export advantage in the post-war period.

VI

It seems clear from this brief survey that the development of a workable system of trade for the post-war world—a system acceptable to both free and planned economies—will have to be an evolutionary process. The International Trade Organization and its Charter can do no more than set the process going, by providing the machinery and the framework of reference for continuous international supervision and revision of trade practices and policies. What the result will be we cannot foresee, but it will certainly be very different from the nineteenth-century system. It will be a compromise between the desire to benefit from freer international trade and the desire in so many countries to protect internal planning. The fundamental criterion is the necessity of two-sided adjustment. If the experiment is to succeed, we cannot expect to impose our kind of economic system, and the kind of international trade system that goes with it, upon the rest of the world. But it would be no less a mistake for other countries to assume that they can have the advantages of multilateral trade without yielding to any of its compulsions.

As a working guide toward this kind of compromise, the key principle of the Charter is that of nondiscrimination. Through the escape clauses the Charter permits trade restrictions and controls in a wide variety of circumstances, but it tries to hold fast to the essential principle of the multilateral system, which is to buy in the cheapest market and sell in the dearest. Whether this

⁷ *Economic Journal*, vol. LVI, June 1946, p. 185.

principle can be given force and substance in such a mixed world is the core of the problem.

The task becomes more difficult the greater is the difference in the nature of the economies embraced within the system. One question on which we have no light as yet is whether a completely controlled economy like that of Russia can fit acceptably into the kind of system we are trying to devise, or would act in good faith as a member of such a system. Thus far, Russia has stayed out of the ITO discussions, as she has stayed out of the Monetary Fund. This may be the better course, from our point of view as well as hers, until we know more about the possibilities of trade and monetary coöperation among nations less widely separated in kind. Russian foreign trade thus far has been astonishingly small, and perhaps the chief question at this stage is, not whether Russia herself should be included in ITO, but how far she may extend her influence and her system over other countries.

There are questions about the workability of the principle of nondiscrimination involving other countries than Russia. One of the chief is its applicability to state monopolies and state trading. Any kind of trade or monetary restriction, even a tariff, has some discriminatory effect. But so long as trade is between individuals (and not dominated by cartels, against which the Charter takes a strong stand) there is a much better possibility of its according with competitive commercial principles than when the trade is between individuals in some countries and state monopolies in others. Probably only experience can decide how feasible nondiscrimination is in such a case, but the farther the movement toward planned economies goes in other countries, the more this will become the test question for the success of ITO and its Charter.

In the Charter there are many qualifications and exceptions to the rule of nondiscrimination, involving such difficult matters as international distribution of commodities in short supply, quotas imposed under intergovernmental commodity agreements, and the difficulties of establishing global import quotas without discriminating against countries of origin. We are brought back to the fact that at best nondiscrimination will work imperfectly in the present kind of world. At the same time, attempts to force the principle unduly might well have bad effects. To the extent that we put pressure on other nations to

give up their present arrangements before we are prepared to offer better ones, we are likely to increase the financial cost to ourselves of reconstruction. Moreover, nondiscrimination should apply to services we supply to others (such as shipping) as well as to goods they buy from us; and when we apply it to goods we ought not to do so in a spirit of seeking advantage for ourselves. The British have been saying that if they have not the dollars to buy tobacco (or it might be food) we ought not to prevent their getting it elsewhere if they have the money or the goods to trade for it. Nondiscrimination ought not to mean that if countries cannot buy from us we will not let them buy from others.

VII

In a multilateral trade world, many of the current difficulties would disappear. We would not, for instance, have the distortions of soft *versus* hard currencies; a country's trade could be cleared with all others as a whole. We are seeing today, as in the pre-war period, the vicious-circle consequences that ensue when multilateral trade breaks down. And we are finding it no easy matter to live in a world part planned and part free. Thus Belgium, after correcting her internal inflation by drastic monetary measures, removed controls and has enjoyed perhaps the best recovery in Europe. But she is finding it hard to submit to British restrictions on imports while her own markets remain open to British goods. Sweden, which has been moving increasingly toward a planned economy since the middle thirties but has prided herself on her multilateral trade policy, has since the war made a trade agreement with Russia and has appreciated her currency to shut out the effects of our price inflation following the breakdown of OPA. But the combination of export trade to Russia and other countries financed by Swedish credits and of cash-financed imports whose volume has been stimulated by the currency appreciation has been draining her exchange reserves. Last March she was forced to impose a direct control of imports, which drew a rather sharp note of inquiry from this country. There are indications that the trade position of Canada, which also appreciated her currency to stave off our high prices, is developing along similar lines.

Developments of this sort in the transition period, along with the British difficulties, the uncertain future of the German econ-

omy, and the many other uncertainties in Europe, do not suggest the early reestablishment of a multilateral trade system. But they do indicate the necessity of starting from where we are and not trying to impose some system ready made. One point we should emphasize for ourselves is the need for tolerance and understanding of the difficulties of others. The main hazards and hardships rest upon them. As the London *Economist* has been emphasizing, a policy of austerity in Britain or elsewhere implies for its success an attitude of leniency in other countries, and particularly here. For the transition period, and perhaps for some time thereafter, our attitude toward bilateral agreements and discriminatory practices will have to take account of circumstances, and the question to be asked should be whether they are likely to encourage a growth of trade or have the opposite effect, rather than whether they violate the pure principles we are seeking to promote.

The International Trade Organization can hardly be inaugurated before the latter part of 1948, and, as in the case of the Monetary Fund and exchange restrictions, its provisions regarding trade restrictions will not go into effect until the end of the transition period. For the success of the experiment much will depend upon what happens between now and 1951. In creating conditions favorable to the restoration of a multilateral trade system, the heaviest responsibility will be our own. Granted that the outcome must be some kind of compromise, will it be possible in such a heterogeneous world, part controlled and part free, to move in the direction of the multilateral system, which is the logical counterpart of our free-enterprise economy, or will the balance swing the other way? Perhaps it is rash to try to answer the question, but it does seem clear that the greatest contribution we can make toward preserving our kind of economic system, here and elsewhere in the world, will be through the maintenance of a stable and prosperous economy at home coupled with a liberal and constructive trade and investment policy abroad.

REMARKS BY THE CHAIRMAN

CHAIRMAN LEFFINGWELL: We are all very grateful to Dr. Williams. I could not imagine a more thoughtful or more generous approach to the problem of international trade that confronts us. It seemed to me that Dr. Williams showed a truly British capacity for understatement when he said that he had had some reservations about the Bretton Woods plan. I compliment you, John!

This country did its very best after the last war to break down the economic system of the world by the Fordney-McCumber tariff and the Hawley-Smoot tariff, by insisting upon the collection of war debts long after it became apparent that they were uncollectible. We did what we could to bring on our own downfall in 1932. I think that Dr. Williams has pointed out to us the importance of remembering that our own particular crimes against international trade may be just as harmful to us and just as harmful to the world as the crimes which we think we see in the conduct of other nations.

Now I call your attention to the second topic of the afternoon, "The Economic Systems of the Democracies and the Totalitarian States". Our speaker was formerly a professor of economics at the University of Vienna and was formerly attached as an expert to the Finance Committee of the League of Nations. He is now an expert of the Federal Reserve Board in Washington. Mr. Haberler!

THE ECONOMIC SYSTEMS OF THE DEMOCRACIES AND TOTALITARIAN STATES

GOTTFRIED HABERLER

Professor of Economics, Harvard University

BY a totalitarian economic system or policy I mean an economic system or policy that largely eliminates or makes necessary for its success the elimination of basic economic freedoms—the freedom of consumers' choice, the freedom of choosing one's occupation, the freedom to start a business and invest one's money, the freedom to work or not to work, the freedom to move and change the place of work. These economic freedoms are not only valuable in themselves but there can be no doubt that a certain measure—although it is not easy to say how large a measure—of economic freedom is essential for the preservation of the more fundamental human and political freedoms as laid down in the bill of rights.

Unfortunately, the boundary which separates the sphere of totalitarian economic policy from that economic policy which is compatible with freedom and the democratic way of life is not clearly marked. It is clearly not true that only a strictly laissez-faire, do-nothing policy is compatible with democracy and freedom. No simple formula such as those proposed by my friend Professor Hayek in his *Road to Serfdom*—"planning for competition" or "policies compatible with the rule of law"—is satisfactory. The question is too complicated for a short formula and needs elaborate, casuistic treatment. This I cannot attempt here, but I should like to point out that, although there exists in any given historical situation such a boundary line which it would be dangerous to overstep, this line shifts in time and it is not the same for different countries. It is not today where it was fifty years ago, and it is safe to predict that in another twenty years it will not be where it is today. A country like Great Britain with a strong tradition of democracy and freedom, an efficient and honest civil service, evidently can

venture farther afield than, say, Italy or France or any Latin American country or even the United States, without running the risk of being forced to give up essential freedoms and turning the country into a totalitarian police state. Whether at the present time Great Britain is not going too far, I would not be sure. It seems to me that she is on the border line; but I personally am convinced that if it should become clear, as may very well be the case, that the economic policy of the Labor Government is not only economically unsound but also incompatible with democracy, democracy and freedom will prevail and the socialist economic policy will be modified.¹

My contention then is that economic regimentation, from a certain point on becomes incompatible with political democracy. (With Mr. Molotov absent, and with only twenty minutes at my disposal, I take the chance of not defining formally what I mean by democracy.) We may now ask the opposite question: Is the absence of political democracy, that is, is an oppressive political dictatorship incompatible with a large measure of laissez-faire in economic matters, that is, with liberal economic policies? My answer is no, at least not under all circumstances. There have been cases of very oppressive police states which pursued nevertheless a very liberal economic policy.² A good example is the Second French Empire of Napoleon III. It was a police state of the most rigid and oppressive kind, but it pursued an economic policy which today we would call ultra-liberal (liberal in the old-fashioned laissez-faire sense). It was Louis Napoleon who signed the famous Cobden Treaty with England, which marked the climax of the short-lived free-trade period in Europe. Or, to cite a more recent example, even Mussolini, during the first years of his régime, pursued fairly liberal economic policies. In the Russian and German brand of totalitarianism, on the other hand, politi-

¹ What is disquieting is not so much the nationalization program, to the extent that it has been carried out or mapped out for the next three years, but the maintenance—and evidently maintenance with gusto—of wartime controls (price fixing, rationing, allocation, etc., in one word, of controlled inflation).

² Some people will say that a totalitarian régime by definition must embrace the totality of social spheres including the economic system. This is, of course, true if totalitarianism is so defined, but it would not be a very useful statement to make.

cal dictatorship and suppression of elementary human rights and freedoms were inextricably linked with economic regimentation from the beginning. Their example, especially the German and its apparent economic successes, made a deep impression, not only on other dictators—Mussolini, Franco, Perron, and others—but also on democracies. Therefore, it is safe to say that they have set the pattern for a long time to come. It is hard to think that future dictators anywhere will pursue liberal economic policies, like Napoleon III or Mussolini in the early years of his régime.

I do not think that it can be said that any of the modern totalitarian régimes—the Russian, Italian, German, Spanish, Argentinian or Japanese or wherever we draw the line—has been created from the economic side, in the sense that the pre-totalitarian régime pursued interventionistic economic policies which became incompatible with a non-authoritarian political and social framework. I think the development was in every single case the other way round: political dictatorship sprang up which quickly transformed the economic system of the country according to the totalitarian pattern.

It can, however, not be denied, it seems to me, first, that the rapid perfection of an efficient totalitarian pattern was aided or even made possible by the development of interventionistic policies on the part of previous governments and by the existence, necessitated by those policies, of an efficient administrative apparatus; and, secondly, that the popular demand for a strong régime and its initial popularity were greatly enhanced by adverse economic conditions which were often the consequence of badly conceived or mismanaged economic policies. Without disastrous inflation, deflation and depression Hitler would hardly have come to power, in spite of the lost war and in spite of a certain ideological and historical predisposition of the German people. A most unfortunate configuration of political, psychological, social and economic factors was required to bring Hitler to the top and to make his régime economically possible and successful. To mention just one economic element in the situation: If there had not been a deep depression and an unemployed reserve army of five to six million men at the time when Hitler came to power—in other words, if he had not inherited a situation which was ideal for a successful expansionary policy—

he could not have provided the German people with guns *and* butter at the same time for several years, there would not have been spectacular economic successes, and he would have found the going much harder.

Let me devote the rest of my time to a discussion of the rôle of inflation and deflation in the rise of totalitarian régimes and their maintenance in power. There is no doubt that, apart from war itself, inflation and deflation are the most powerful economic factors upsetting economic equilibrium.

Let us look, first, at the case of inflation. Here we have to distinguish two kinds, "open" and "repressed" inflation. (This distinction has been rightly stressed in recent writings of some continental economists, Jacques Rueff and Wilhelm Roepke.) After the First World War, inflation was of the open type, it was inflation in a comparatively unfettered economy. In the twenties, attempts at price fixing, rationing, allocation of labor and material, exchange control were very weak, inefficient and unsuccessful compared with what happened in the late thirties and after the Second World War. Prices were allowed to rise freely and there was a continuous and rapid mutual adjustment of price level and exchange rates, between the internal and external purchasing power of money. These open, *laissez-faire* inflations wrought havoc with the German, Italian, French and other economies while they were going on and left some dangerous legacies behind. But looking back it is remarkable how quickly and completely the various economies recovered from the ordeal.

I think the deflation of the early thirties was a greater calamity than the open inflation of the early twenties. Some people will argue that the deflation was nothing more than the necessary consequence of the hyperinflation of the early twenties or of what has sometimes been called "latent" or "concealed" inflation of the late twenties. Both these views seem to me untenable and based on a much too simplistic view of economic depressions. Deflations and depressions have deeper roots and cannot simply be prevented by avoiding inflation.

The type of inflation which was developed and perfected in Nazi Germany in the later thirties and was then during the war copied by many other countries and is now in many countries continued into the post-war period is an entirely different mat-

ter. I call it "repressed" inflation. It is the direct and more dangerous offspring of the open inflation of the twenties. Because the open inflation has been carefully studied and is well understood by many people, it no longer works. It is a workable method of confiscating a large part of the national income for government purposes only, if it is not well understood by the majority of the people. But you cannot fool the majority of the people all the time at least not by the same device. This is especially true in countries which had much experience with inflation such as Germany. This is the reason that the symptoms of inflation had to be repressed, and prices and wages have to be fixed. The inescapable consequence is rationing of consumers' goods and allocation of means of production, of labor, materials and equipment, etc. If the inflationary pressure is strong, a repression of its symptoms must lead very quickly to a completely controlled economy. The stronger the pressure of inflation, the heavier the repressive measures that are necessary. Europe today offers many examples of countries in different stages of this process: Italy, on the one hand, where all controls have broken down and where an old-fashioned open inflation is in full swing; England, on the other hand, with a controlled, repressed inflation; France and Holland in between; and so on. Of course, surrounding conditions, social milieu, war damage, and dislocations are not the same in different countries so that it would require an elaborate study to disentangle the consequences attributable to inflation and the measures and policies used to repress its symptoms. Such a comparative study would be extremely important and instructive.

I agree on the whole with Rueff, Roepke and others that under present conditions inflation is likely to lead to repression of symptoms and to a degree of regimentation and central control which is in the long run incompatible with political democracy and freedom. In Rueff's words, inflation today leads directly to slavery.

However, this statement needs qualification. Let us remember the words of the great Victorian economist, Alfred Marshall. "Every statement in regard to economic affairs which is short is a misleading fragment, a fallacy or a truism."

Rueff's statement is evidently not true of any kind of inflation, only for strong inflations and a lot depends on the sur-

rounding social-political milieu. The era of open inflation is not yet quite over, as the Italian and some Latin American examples show.

But let me now, in conclusion, say a few words on another facet of the problem which is more important from the American point of view. There is a tendency to extend the concept of inflation beyond all reasonable bounds. Concretely, inflation is interpreted to include any expansionary policy, even if it is undertaken in times of depression to counteract deflation, to check a fall in prices rather than to bring about a rise. In other words, the fear of inflation is used to discredit any kind of anti-depression, full-employment policy. This position is often supported by the entirely unwarranted optimistic assumption that there never could and would be a depression, if there were no deliberate policy of expansion.

I think this is an entirely untenable and in its consequences extremely dangerous theory. It is, of course, true that a full-employment policy can be overdone. There is such a thing as "over-full" employment. The words "full employment" should not be taken too literally. Full employment in the technical sense is compatible with several million unemployed—how many depending upon concrete circumstances. I think it is true that Lord Beveridge's proposals are incompatible with a free-enterprise economy. You could not, as he suggests, reduce unemployment to a maximum of 3 per cent by expansionary policies without maintaining a tremendous inflationary pressure, which would necessitate extensive regimentation. But we should not pour out the child with the bath water. We have to guard against inflation and an extreme full-employment policy. "Over-full" employment gradually merges with genuine inflation. But the preoccupation with inflation must not make us blind to the dangers of deflation. And it is simply not true that deflation can occur only in reaction to inflation.

The capitalistic, free-enterprise system in the United States has again performed miracles during the war and during the transition from war to peace. It is nevertheless regarded with hostile feelings ranging from suspicion to violent hatred almost everywhere in the world outside North America. Under these circumstances, even a partial and temporary failure of this system to function smoothly could easily have serious, perhaps

disastrous, consequences. The capitalistic system is subject to such recurrent disturbances; the business cycle is still with us and we can be sure that there will be a cyclical depression sooner or later.

To be sure, a depression, if left alone, will lift sooner or later. But the point is that in the present social and political milieu which is so hostile to the free-enterprise system we cannot wait for the natural recuperative forces. If we do not adopt a monetary and fiscal policy of expansion—monetary policy alone would not be enough—to cut short the depression, if we do not apply these policies which can be conducted in a way that makes them perfectly compatible with the free-enterprise system and avoid any undue regimentation of industry, we can be sure that the pressure for the adoption of much more drastic policies of regimentation will become irresistible.

REMARKS

CHAIRMAN LEFFINGWELL: I thought that was an acute analysis. I was particularly interested in what was said by Mr. Haberler about repressed inflation. It is a sort of "Typhoid Mary" going around the community, communicating a disease which is not apparent on the surface.

We invented methods of preserving money from deterioration in some countries by making money entirely useless or almost entirely useless and substituting a coupon and the privilege of standing in a queue to get what was wanted. That is a kind of inflation that may last longer and debilitate the patient more than even the exposed inflation which so many nations suffered after the First World War.

One thing about our speakers today is heartening. They are learned economists; but they have stepped out of the academic halls, and every one of them is helping to guide the government of this country and has at one time or another been an adviser in world policies. That contact between the world of practical affairs and the world of academic thought and learning must be, in view of changed world conditions, one of the reasons for our hope of finding solutions, now that governments, more and more, whether we like it or not, take control of our affairs.

The third speaker this afternoon, who will speak on "International Agreements and International Trade", must be speaking in terms of prophecy, because there has not been much agreement yet. He is a professor of economics and Assistant Secretary of State of the United States for Economic Affairs. I have great pleasure in introducing to you Mr. Willard Thorp!

MR. WILLARD THORP: Mr. Chairman, before I start speaking, I think perhaps I should warn you that I am going to shift the level of this discussion somewhat.

When I saw the announcement of the program and realized that the wisdom of Harvard and Columbia was going to be brought to bear on international economic problems, I saw an opportunity for me to escape from that particular responsibility. I felt even more keenly the results of the fact that I had already made six speeches this week, analyzing international economic affairs of the world. I thought, therefore, that it was time, in spite of the fact that that speech has gotten mighty good, to venture into some other type of discussion. So my speech this afternoon is directed to the problem of how countries go about getting into agreement with each other. I then propose to discuss some of the problems that we are facing, as a result of the new way of trying to reach international agreement that has appeared in so many different forms in the last few years, primarily since the war.

INTERNATIONAL AGREEMENTS AND INTERNATIONAL TRADE

WILLARD L. THORP

Assistant Secretary of State for Economic Affairs

FOREIGN policy, by definition, has to do with matters which extend beyond the boundaries of the country concerned. From the point of view of international relationships, there are three ways in which the problems which arise may be handled—by unilateral action, by bilateral action, and by multilateral action.

In most instances, the cases where unilateral actions are involved are those where the problem is regarded by the appropriate authorities as primarily a domestic one, with its international aspects, if any, being decidedly secondary. It is obvious that a system of price controls, for example, will have a significant impact outside a nation's boundaries, at least in the case of certain specific commodities, but the establishment of such a system of controls might be regarded as so much a domestic problem as not to require or even permit international consultation. Similarly, actions in the field of taxation are usually viewed in terms of domestic considerations, even though the interests of foreign nationals may be involved.

Unilateral action also appears from time to time in cases where a strong nation acts in disregard of a weak one. Thus territorial expansion, like the ill-fated Italian aggression in Ethiopia, was certainly not a negotiated action. At the other extreme, unilateral action also appears in cases of good will like the payment made by the United States government for goods requisitioned in Italy, although this was not required by the Armistice terms. But it is obvious that most international problems involve mutual interest and concern. Equity and justice require some form of international collaboration in their solution.

The bilateral approach is undoubtedly the most usual form of international consultation. Most international problems

arise out of some situation affecting two countries. After all, most transactions themselves are bilateral—a buyer and a seller are involved—or one person infringes on the alleged rights of another. The next result is that most aide-memoirs, notes and memoranda are exchanged bilaterally between foreign offices; most international conversations are between representatives of two countries; and most of the situations where persisting problems appear have been dealt with by the construction of an elaborate network of bilateral arrangements, agreements or treaties.

In the past, the bilateral approach has been the chief vehicle of international arrangement. The first treaty entered into by the United States of America was with France. This treaty of "Amity and Commerce" between "The Most Christian King, and the thirteen United States of North America", was negotiated by a commission headed by Benjamin Franklin. It well illustrates the nature and atmosphere of such treaties, starting with a statement that the parties, being

willing to fix in an equitable and permanent manner the Rules which ought to be followed relative to the Correspondence & Commerce . . . between their respective Countries . . . have judged that the said End could not be better obtained than by taking for the Basis of their Agreement the most perfect Equality and Reciprocity, and by carefully avoiding all those burdensome Preferences, which are usually Sources of Debate, Embarrassment and Discontent; by leaving also each Party at Liberty to make, respecting Commerce and Navigation, those interior Regulations which it shall find most convenient to itself; and by founding the Advantage of Commerce solely upon reciprocal Utility, and the just Rules of free Intercourse; reserving withal to each Party the Liberty of admitting at its pleasure other Nations to a Participation of the same Advantages.

This, our first treaty, was concluded in Paris on February 6, 1778, and was ratified by Congress May 4, 1778. It was followed by a similar understanding in 1782 with the Netherlands, another in 1783 with Sweden, and a third with Prussia in 1785.

From that time on, bilateral treaties were entered into with country after country. During its history representatives of the United States have negotiated more than 100 bilateral com-

mercial treaties. These treaties of friendship, commerce and navigation are among our most important international instruments, for they establish a basis for our economic relations with other countries. Historically, they hold an honored place in the record of American foreign policy.

The treaties previously mentioned were effective means of support in our own effort to win and establish our political and economic independence. Later, it was by means of such treaties that our government sought to establish and maintain the American doctrine of the freedom of the seas, and these treaties, with their emphasis upon the rule of nondiscrimination in the treatment of shipping, contributed, in the first half of the nineteenth century, to the achievement by the American merchant fleet of the dominant position in the maritime world. More recently, after the First World War, a whole series of new commercial treaties served to reestablish and regularize our commercial and other relations with the new nations that arose from the dissolution of the old empires of central and eastern Europe.

At the present time, the State Department has a program vigorously under way for modernizing and extending the coverage of our commercial treaties. There are now in effect some twenty-five relatively comprehensive commercial treaties, about a score of others the subject matter of which is somewhat limited, and an approximately equal number of executive agreements, exclusive of the agreements with twenty-eight countries concluded under the provisions of the Trade Agreements Act of 1934, relating to more specific problems in the same general subject matter. Nevertheless, we are without such contractual bases for our economic and commercial relations with a considerable number of the more important trading countries.

In addition, many of our existing treaties are sadly out of date. The treaty with Great Britain of 1815, that with Denmark of 1826, and that with Colombia of 1846 illustrate the ancient character of parts of our commercial treaty structure. At this moment, the Department has in the planning, drafting or discussion stage about twenty projects for new comprehensive commercial treaties. In the case of China, negotiations have been completed and the proposed treaty is now before the Senate for its consent to ratification.

The term "comprehensive" is used advisedly with respect to these treaties, for the extent of subject matter covered is ex-

tremely wide. The broad fields usually dealt with are three: the status and activities of individuals and organizations, general principles relating to the exchange of goods, and rules affecting navigation. In the first category are included rules as to entry, travel, residence, and the carrying on of specified activities by individuals; the status, organization and activities of corporations; freedom of worship; acquisition, disposition and protection of property; access to courts; freedom from unreasonable searches and seizures, from discriminatory taxation, and from compulsory military service.

Provisions dealing with the exchange of goods relate to the general principles that should govern the application of import and export duties, internal taxation of imported articles, the making of import and export quota allocations, the regulation of foreign exchange, and the operation of monopolies and the granting of public contracts and concessions as they affect trade.

Navigation provisions relate to such matters as entry of vessels into ports, assistance to vessels in distress, and freedom from discriminatory charges and practices.

There is, of course, no prescribed limitation upon the subject matters of such treaties. In its program of modernizing its commercial treaties, the Department is giving attention to such matters as more comprehensive rules regarding the rights of corporations; more detailed coverage of exchange control, government monopolies, and nationalized enterprises; provisions favoring the practice of commercial arbitration, and for furthering activities relating to freedom of information.

Certain matters peculiarly appropriate for regulation by bilateral instruments are those of particular concern between ourselves and our immediate northern and southern neighbors, such matters as the use of boundary waters, measures to safeguard livestock interests on both sides of the border, the protection of migratory birds and game animals, and the regulation of fisheries.

The working out of arrangements for the avoidance of double taxation is another field for bilateral negotiation, and the United States has recently entered upon a program looking to the conclusion of a number of double-taxation conventions. An illustration of another area where bilateral agreements are being actively negotiated at the present time is that of civil aviation. The United States has recently concluded agreements with

twenty-nine nations which establish the basis for the development of international commercial aviation.

It is obvious that there are many situations in which the problem is limited to only two countries and where the bilateral approach is all that is needed to deal with the problem. It still remains the chief method of carrying on international affairs. However, today I wish to call to your attention the development of the multilateral approach, particularly in the economic field, and to discuss some of its advantages and difficulties.

The multilateral approach is that by which a group of countries reaches agreement on some subject in which they all have an interest. It takes the form of the establishment of a multilateral convention, agreement or treaty, or the creation of some international organization which may appropriately deal with some specialized group of problems. The multilateral approach is, of course, not a new one. Where wars in the past have involved only two countries, the peace settlement has been bilateral, but there have been many instances where wars have drawn in other interested parties and where a multilateral peace has been negotiated.

For almost the first hundred years of its existence, the United States entered into no multilateral treaties, agreements or conventions whatsoever. The first international agreement arrived at by an international negotiation or conference of which I have found record was not handled by the State Department, and is not even published in the official compilation of treaties.¹ This came about because of the authority given by Congress to

¹ An earlier special case is that of the arrangement for the operation of the Cape Spartel lighthouse in Morocco at the southern entrance to the Strait of Gibraltar. In a convention signed May 31, 1865 and ratified by Congress and the President, eleven nations agreed with Morocco to provide "the superior direction and administration... of the Pharos" and to make equal annual contributions for that purpose. In early years, the contribution of the United States was \$285 per year, but this amount has now increased to nearer \$1,000 per year. The construction was done by the government of Morocco, but the Sultan, not having a naval or commercial marine, was unwilling to bear the costs of operation. The convention established the permanent neutrality of the lighthouse in this curious provision, "the contracting Powers bind themselves, each so far as concerned, to respect the neutrality of the lighthouse, and to continue the payment of the contribution intended to uphold it, even in case (which God forbid) hostilities should break out either between them or between one of them and the Empire of Morocco."

the Postmaster General to enter into treaty arrangements concerning postal matters, with the advice and consent of the President. The United States sent representatives to the first International Postal Congress which convened in Berne on September 15, 1874. A resulting international treaty concerning the formation of a General Postal Union was formally approved by the Postmaster General and the President on March 8, 1875. It established a degree of uniformity of foreign postal rates and established conditions of exchange. It set up a central office to facilitate the distribution of information, the resolution of disagreements, and the development of further agreements in the interests of the postal union. However, it should be noted that the establishment of the union did not supersede the negotiation of various bilateral agreements in the postal field.

The next so-called multilateral treaty in the negotiation of which the United States participated was in 1875. It related to the establishment of a "scientific and permanent international bureau of weights and measures... at Paris." Our next act was to subscribe in 1882 to the multilateral Geneva Convention of 1864 concerning care of wounded in time of battle, the neutrality of those involved, and the creation of the symbol of the Red Cross. In 1883 came the first international convention concerning patents, trademarks and commercial names, and in the following year, a general convention for the protection of submarine cables. In 1886, a convention was concluded in Brussels looking toward the exchange among governments of their official documents. In 1890 came the elaborate multilateral treaty for the repression of the African slave trade and the formation of an International Union for the Publication of Customs Tariffs in Brussels.

This is the entire list of multilateral treaties and conventions to which the United States of America had adhered by 1900. As you can see, it is limited to very specialized and limited subject matter which did not contain the elements of violent controversy.

During the early years of the twentieth century, the area covered by such multilateral conventions was slowly and slightly extended. In the social field, agreement was reached with respect to the white slave trade, sanitary conventions and certain drug controls. Full-dress conferences were held to set

up so-called rules of peace and war—the two Hague Peace Conferences in 1899 and 1907 and the Central American Peace Conference in 1907. In 1910 began the development of the elaborate “safety at sea” international regulations, and some slight order was brought into the fields of the wireless telegraph and radio telegraph by multilateral agreement.

Between the two World Wars, the use of the multilateral instrument was further extended. A number of such treaties were created for this hemisphere, being limited to the American Republics. In the economic field, there were multilateral conventions on the preservation and protection of fur seals (1911), joined later by others relating to whaling (1931), silver (1933) and sugar (1937).

Now that we are so near to the present in this historical review, it should not be necessary to take time to describe the great impetus which the war gave to the use of multilateral agreements. With most of the nations of the world included among the Allied and Associated Powers, and with the war being the type of over-all effort which it was, it was obvious that a group operation was involved and that multilateral procedures would be used. While much of this wartime understanding took the form of executive agreements, there were some documents of great formality, such as the Chapultepec Agreement of 1945. The most significant point of all is the fact that the end of the war brought universal agreement that hereafter international issues should be solved on a multilateral basis wherever appropriate. The outstanding example of the application of this principle was, of course, the establishment of the United Nations. The Charter of the United Nations and the agreements setting up its many subsidiary and related organizations constitute a vast extension of the multilateral treatment of international questions.

It is no new venture for the United States to participate in an international institution. We all remember too clearly our failure to join the League of Nations, but we should also remember that, in the past, we have adhered to conventions by setting up not only the agencies which I mentioned earlier, but also such agencies as the Institute of Agriculture, the International Office of Public Health, the Pan American Union, the International Labor Office, and the Permanent Court of International Justice.

In the economic field, we have gone through a substantial evolution in our attitude toward the international implications of our own acts. I think it would be fair to say that, until 1934, American tariff policy was viewed by Americans as essentially a domestic matter. Many foreign analysts of the problem pointed out the difference between the European and the American approach on tariffs during this period. In Europe, each nation realized that its tariff policy had direct significance to other countries and therefore it considered its tariff policy as part of its over-all foreign policy. In the United States, the argument was within the country, between those industries whose concern was primarily with the maintenance of protection and those who wished to buy or sell abroad. There was no particular regard for how this or that decision might affect the economic interests of some other country and even less for the secondary effects upon us of the actions which might in turn be taken by the country concerned.

The Reciprocal Trade Agreement Act represented a major development in approach. Congress delegated to the President broad powers to negotiate with other countries changes in our tariff. Our tariff policy was placed in relationship to the tariff policies of other countries. Tariff concessions were to be on a mutual and reciprocal basis. The reciprocal trade agreements thus far negotiated have been bilateral instruments.

Now we are reaching a third stage in which the multilateral method has assumed much greater importance. We are dealing and propose to deal with a number of international economic problems on a multilateral basis and are planning to extend the use of this method even further. Thus, UNRRA was set up to establish the responsibility for post-war relief as a general obligation to be handled multilaterally. The International Bank for Reconstruction and Development and the International Monetary Fund are given responsibilities far beyond those ever given before by the several governments to any economic agency. And now the proposed Charter for an International Trade Organization not only sets forth a set of principles aimed at eliminating uneconomic discriminations and reducing barriers to trade, but also establishes an organization which will provide a regular forum for the exchange of ideas on trade matters and the reduction of trade controversies.

It is not surprising that the multilateral approach should have come so strongly to the fore. The world has been growing smaller and smaller while the necessary arrangements for economic activity have become increasingly complex. Different bilateral arrangements on the same subject by any one country with several others make for great administrative confusion at home. But the basic reason is not administrative. Many of these economic situations are interlocking. Trade may be triangular or quadrilateral. Certainly financial currents flow back and forward and around. Certainly it makes sense for the countries of the world to meet together, face these economic problems together, and try to find the best solutions possible by their joint and combined effort.

The bilateral procedure of international arrangement was customarily carried on without fanfare or public awareness. Perhaps a very limited number who have a special interest in the matter know that at this moment we are in the process of negotiating such different bilateral agreements as a civil aviation agreement with the Union of South Africa, a Lend-Lease settlement with Norway, and a fisheries treaty with Mexico. On the other hand, everyone knows about the meeting of the Council of Foreign Ministers in Moscow, and the Security Council at Lake Success.

I doubt very much that we have yet reached the point where we can place these public multilateral negotiations in their proper perspective. In the first place, we are inclined to expect something much more rapid than is produced by this process. We ought to know, from our observation of Parliaments and Congresses in action, that hammering out policy when many opinions and prejudices must be considered requires time and patience. As compared with a bilateral negotiation, the multilateral process introduces a whole series of problems of procedure which seems inevitably to consume extraordinary amounts of time and energy. The multilateral negotiations are also likely to be multi-lingual, and this takes time. Furthermore, we must remember that the participants are representatives of governments—that they frequently are not free to shift lightly from one position to another, but must await authority from individuals or bodies somewhat removed from the time pressure of the conference room. It is a great step forward to obtain

statements of position, to identify and define specifically the disagreement, and to have a place to consider and discuss.

In general, we Americans are too frequently disappointed if problems are not immediately solved. In the international field, agreements inevitably take time. We have many examples of this before us. The refugee and displaced persons problem was one recognized by everyone as urgently needing immediate treatment. Discussion of the problem went on all through the days of UNRRA, and the new International Refugee Organization is only now in the process of being born. Here was a simple problem and also an urgent one, but a few issues were found which formed the basis of endless debate and it took time to uncover a workable compromise. One can perhaps be encouraged that a solution eventually was found. We may learn to do better as time goes on, but we should not be too disturbed by failure to get quick and decisive action.

It is also important to appreciate fully the implications of the fact that the multilateral method of dealing with international problems brings the actual process of international negotiations out into the open. Discussions on prospective bilateral arrangements have seldom been in the public eye. International organizations operate in the open, even to the extent of making an issue over how many newspapermen could go to Moscow. This has both advantages and disadvantages. The great advantage is that it does permit the public to have information about trends of policy before irrevocable steps are taken. It also may please the diplomat who has been charged with not having a consistent foreign policy. As a matter of fact, one of the reasons why foreign policies have seemed inconsistent is that in the past they have become known only through publication of actual and final agreements and acts. These acts and agreements, however, frequently represent compromises to meet in part the position of one or another foreign country. Therefore consistency, which may be present in the initial positions taken, tends to disappear as that position is modified in various ways in dealing with various other governments. At least the multilateral technique makes public the initial position as well as the ultimate solution of the problem.

However, it also should be noted that this fact in itself may make agreement more difficult. Once a position has been taken

publicly, the element of prestige enters into the picture and any modification must be judged not only in terms of its own extent but in terms of the effect it will have on the prestige of the negotiator and of his country. Anyone familiar with the operation of groups of people—for example, large committees—knows that final solutions are seldom found in discussion in which a substantial number of people participate. They are more apt to be worked out by a more limited group working quietly and out of sight.

This problem of operation in public is, of course, not a new problem and certainly not an insuperable one. It is a problem faced by any public body where its procedures call for deliberations in the open. However, in the international field it is of the greatest importance that we do not overemphasize a scoreboard of victories and defeats but keep our eyes on the necessity for finding solutions and on the quality of solutions found.

Another implication of this factor of publicity is the tendency toward exaggeration. What were points in a debate become newspaper headlines. Controversies are news, agreements are not (except perhaps at the Council of Foreign Ministers). Different countries have different forensic styles. A mild criticism in one language is an insult in another. There is a danger that we may overrate the disagreements which may appear from time to time, that tension may be created beyond that justified by the basic facts. It is not impossible, of course, that efforts may be directed at some times intentionally to create these tensions. There is no cure for this general tendency to exaggerate other than understanding, good will and common sense. It would be a sad confession of lack of faith in our underlying principles to suggest that it is a step backward to bring the consideration of these problems out into the open. I do not believe that it is. But we must achieve broader perspective in our judgment concerning the process and results of international negotiations, and I believe that we will.

There is one other problem which we must all have in mind which does not arise in simpler types of negotiation. In the case of a bilateral negotiation, if there is disagreement, a country is able to stand by its own position and that ends the matter. Prior to the war, nearly all multilateral negotiations proceeded on the unanimity rule and the result was that multilateral agree-

ment always represented the greatest common denominator that could be found for all the participant countries. The necessity of meeting the requirements of every country was of course a very limiting factor. This was the difficulty that haunted multilateral discussion in the inter-war period, particularly in the economic conferences that were held for the most part under League of Nations auspices. For example, the 1927 Convention on the Abolition of Export and Import Prohibitions was probably, up to its time, the most comprehensive and far-reaching multilateral agreement in the economic field ever negotiated. For a time it had a very impressive list of signatories but they quickly drifted away. Even so, it was loaded down with literally hundreds of reservations by individual signatories and the result was that the provisions upon which all countries had unreservedly agreed made a very negligible list.

Multilateral negotiation multiplies the difficulties of getting unanimous agreement a great many times, as compared to the difficulties of getting a series of bilateral agreements. If the multilateral agreements are to be successful, there needs to be a willingness to accept the majority judgment and not to insist that the majority judgment be so watered down as to be acceptable without difficulty to every participant. This difficulty is, I think, the explanation for previous multilateral agreements being confined to such noncontroversial and technical subjects as postal coöperation and safety of life at sea.

Luckily, the unanimity rule has virtually been abandoned. While compromise will still be necessary, action can be taken even if there are some dissenters. However, in the case of a multilateral negotiation, there still is the fundamental issue of how much weight should be given by a country in the minority group to the fact that a majority of countries take a different view in the event that some action is required by it. In the Security Council, the veto power represents a way in which certain of the countries, at any rate, can protect themselves from the majority. In the Economic and Social Council and, in fact, all other organizations of the United Nations, there is no such protection. The case undoubtedly will arise where the United States, like any other country, will find itself faced with a conclusion reached by an international body with which it was in thorough disagreement.

At the Paris Conference, Mr. Byrnes took the position that he would support any proposal for any of the treaties which was endorsed by two thirds of the countries there represented. This policy did not lead to any major difficulty in that case. Obviously, the present situation requires the working out of solutions which can have overwhelming endorsement. But I do suggest that the multilateral approach will mean that on occasion the United States will find itself in the minority. I hope that, in such cases, we will make a determined effort to accept the majority judgment if it does not involve a violation of our fundamental principles. Actually, I think we can have real confidence that the majority of the nations of the world will act with wisdom and discretion.

In one respect, the procedures which we are adopting may be regarded as new, namely, the creation of more or less permanent representation and the establishment of substantial international secretariats. This is still so much in the experimental stage that it is difficult to form any judgment as to its probable effect. It means that a group of people is specifically assigned to making the machinery work. As for the representatives, there is much to be said for the procedure of designating certain individuals who devote all their energies to multilateral negotiation. Anyone who has participated in such activities knows that complete strangers make slow progress, but that, as familiarity develops, time and energy can be saved and there is a somewhat greater possibility of accomplishment. As for the secretariat, that requires the development of real international servants who can put aside their national loyalties. If this can be done, it will be of tremendous value and significance. There have been secretariats before but they have mostly been made up of technical specialists working on international organizations with little political significance. The League Secretariat was able to do much excellent work but it was limited in size and took a somewhat passive rôle as compared with the present activity on the part of the United Nations Secretariat. Obviously this is not a task to be accomplished overnight, but it is the case that something new has been added to the international scene which may be of extremely great importance.

The bilateral approach is not dead—it is very much alive. But the multilateral approach has been greatly extended. I

think there is some symbolism from this for the economic field. We have used the bilateral approach by reciprocally reducing tariff and other trade barriers while continuing the most-favored-nation extension of benefits. Our objective was to increase trade for the benefit of our own producers and consumers. But for most countries, either unilateral action or bilateral barter agreements operate to restrict trade. The multilateral approach, with its emphasis on nondiscrimination and reduction of barriers, is dedicated to the expansion of trade. By its recognition of the necessity for joint action by many countries, it is the natural medium for pursuing the goal of peace and plenty. This application to new fields of an old technique has many problems in its path, but it also has the promise of a better future in an age when the interdependence of all nations of the world is no longer a subject for argument but an established fact of vital significance.

REMARKS BY THE CHAIRMAN

CHAIRMAN LEFFINGWELL: Thank you, Mr. Secretary! It is worth while to remind ourselves, as we have been reminded by Mr. Thorp, how, brick by brick, from the eighteenth century through the nineteenth, the structure of peaceful trade was built up. It is comforting to know that those old, slow, patient methods are to be continued, though we turn toward new and more startling and more difficult methods. It is well to remember how great the difficulties are which confront our government and its representatives as they attempt to evolve, in the broad light of day and in the shattering glare of artificial light and among amplifiers and translators, global solutions. We must hope that these early steps will be viewed patiently and with a little less of the American notion that you must get there right away, or the day before yesterday.

Our fourth topic is "International Investment and Free Enterprise", and our speaker is Professor of Economics at Columbia University. He worked with the War Production Board during the war, with the Foreign Economic Administration, and, more recently, with the Allied Reparations Commission for Germany. I have great pleasure in introducing to you Dr. James W. Angell!

INTERNATIONAL INVESTMENT AND FREE ENTERPRISE

JAMES W. ANGELL

Professor of Economics, Columbia University

I American Foreign Investment Experience, 1919-1938

IN 1914, the world's total foreign investment amounted to some 42 billion dollars. Of this enormous sum, the United Kingdom held nearly half. France and Germany each had roughly a fifth.¹ The United States had only 2½ billions gross, and was actually a net debtor on international investment account. In the next fifteen years this picture changed radically. The First World War led to the liquidation of most of the French and German holdings. During the 1920's the United States, which had been the principal financial arsenal of the Allies during the war itself, also became the principal source of private funds for foreign reconstruction and development. In the space of a few years, our private investors placed over 12 billion dollars abroad. The Inter-Allied war debts apart, we did not quite catch up with the British, who actually lost a little ground but whose head-start was enormous, but we were pressing hard on their heels. Then came the 1929 crash, the onset of the world depression, and the protracted international economic difficulties of the 1930's. For some years, we stopped investing abroad almost entirely. By 1938, what with outright losses, withdrawals of funds and other actions, our total foreign investment had dropped from 15 billions to 11½ billions, barely half the British figure in that year.²

The general situation in 1938 was radically different from 1929 or 1914 in other important respects as well. Many

¹ See Table I, p. 83, below; for the distribution of debtors by regions in 1938, Table II, p. 84.

² Our *net* investment was much smaller; and by 1944 we were a net debtor on combined long and short account. See Table III, p. 84, below.

American investors had become very bitter, because of their losses and disappointments. At the same time, many foreign capital-receiving countries had also become bitter. They felt that a large part of their own acute difficulties during the early 1930's was due to the sudden stoppage and reversal of the flow of American funds, to the American tariff, and in general to the violent effects on their economies of the wide and uncontrolled fluctuations in American economic activity. A precise assessment of the causes at work is not possible here. It seems clear, however, that American commercial and financial policies, or the lack of them, had much to do with the rapid growth of trade and exchange restrictions, and of a widespread movement toward economic nationalism, in other parts of the world during the early 1930's. It also seems clear that our investment losses were due, to a not inconsiderable extent, to the results of our own actions taken *after* the original investments had been made.

A number of other conclusions which are directly relevant to the international investment problems now confronting the world can also be drawn from this American experience between the two wars. These conclusions are not the less important because they are fairly obvious.

First, and most conspicuous, a country which proposes to invest abroad on any substantial scale, and which expects to be repaid in net terms, must also follow policies which make repayment possible. Since net international payments can be effected in any large volume through time only in the form of net imports of goods and services,³ this means that the creditor country must not enforce persistently high tariffs or other restrictions affecting any very substantial part of its potential imports. It also means that the creditor must in fact, whether by good luck or good management, maintain relatively high levels of income and employment within its own frontiers. A country which allows itself to drag along for years in a state of protracted depression obviously offers a poor market to the

³ Net balances can obviously be settled in gold, but no country except the United States could continue this long without disrupting its monetary system (if based on gold), or exhausting its gold holdings. Individual investments abroad can, of course, be serviced from the proceeds of further new investment, and this is in fact what has happened in the case of many investing countries over long periods, but here no *net* international repayment is involved.

rest of the world, and places almost insuperable obstacles in the way of any net repayments of investments which it may have previously made abroad.

Second, it is clearly undesirable to permit wide fluctuations in the total volume of new international investment which coincide with the broad cyclical movements of general business activity in the countries concerned. A stable rate of flow would be better; and contra-cyclical fluctuations in the investment flow, if they could be managed, would be better still.

Third, the activities in which and the purposes for which capital is invested abroad must be judged carefully, both in the light of the prospective productivity of the capital in the receiving country, and in the light of the prospective direct and indirect effects of the capital on the receiving country's own foreign exchange position. The point is so self-evident that it would not be worth making again, if the history of American purchases of foreign bonds during the 1920's were not so replete with examples of the opposite practices.

Fourth, if the foreign investment takes the form of loans, the terms must be moderate rather than severe, and as far as possible should provide for flexibility in the international transfer arrangements prescribed. Many loans which were made in the 1920's at high effective interest rates, and with rapid amortization, went bad,⁴ but might have been perfectly sound with lower interest charges and with reasonable amortization rates. Too high rates will kill the golden goose. Flexibility in transfer provisions is likewise essential, though it is not easy to incorporate in loans made by private investors. At least with respect to pressures arising out of business-cycle fluctuations, however, it can probably be achieved even with private lenders by instituting some device for borrowing the necessary foreign exchange against loan service payments made in the borrower's own currency.⁵

⁴ Despite the losses, the over-all experience of the United States with its foreign investments was by no means unsatisfactory in 1920-1940. See *Economic Reconstruction*, edited by S. E. Harris (New York and London, 1945), p. 359.

⁵ To the extent that its resources and regulations permit, of course, the International Monetary Fund can also in effect perform this function for its members.

Finally, when equity investments are made in foreign enterprises, it is usually highly desirable to arrange for extensive participation by interests in the foreign country, both in the provision of funds and in the actual management. Even where local laws do not make such participation mandatory, the gain in local interest and support is invaluable, both in combating general ill feeling against "the foreigner", and in preventing discriminatory legislation and regulation. It is also usually desirable to build up and train local technical staffs, rather than relying primarily on imported personnel.

II *The Foreign Investment Problem Today*

These are some of the principal lessons that can be drawn from our foreign investment experience in the 1920's and 1930's. Can they be applied to the foreign investment problem that now confronts us?

The present situation is in many ways completely unlike anything we have known before, with respect to the magnitude, character and urgency of the foreign needs for capital, the channels and mechanisms through which these needs will probably be met, and the extent to which broad political considerations will explicitly affect the nature and direction of the actions taken.

The urgency of the need of many foreign countries for goods, services and capital that can come only from abroad is obvious and familiar. For tens of millions of people scattered over a large part of Continental Europe, in India, in China, starvation and cold are still the bitter substance of daily life. The danger of devastating epidemics is still just around the corner. The effects of war and post-war disorganization are still dominant, and the machinery of normal economic life is still far from rebuilt. A substantial part of the immediate needs of these areas for foreign goods and capital will, of course, have to be met primarily on the basis of relief operations if they are met at all. But a number of the countries concerned also can, and will, obtain funds on an investment and repayment basis. Moreover, what will be far more important over time, many countries, both in these areas and in other areas such as Latin America, are working out long-range plans for over-all economic reconstruction and development that are designed to

increase tremendously the general productivity, incomes and standards of living of their populations. In considerable part, these plans will and must be financed at home. But a good deal of the capital, especially in the early years, must be obtained from abroad. What all of these areas lack is not only money, but also sufficient commodities, equipment and know-how to get started promptly enough on an adequate scale.

I know of no authoritative published statement of the total size of these needs. Just before the end of the war, however, in 1945, I took part in what then seemed a rather rash attempt to forecast them; and in retrospect the estimates do not look wholly implausible. Taking post-war emergency, reconstruction and development operations together, we concluded that in the ten years 1946-1955 the world's defensible total requirements for foreign capital, *that should be obtained on an investment and repayment basis*, would come to some 45 to 50 billion dollars; and that this sum can be serviced and repaid if the original terms are reasonable, and if the world's commercial and foreign exchange policies are intelligent.

These figures are of course large, and must be treated as an estimate of an order of magnitude rather than a precise forecast. Lest the size of the figures seem frighteningly unrealistic, however, it should be pointed out that they are not quite as large as the size of the world's foreign investment still effectively in existence in 1938. It should also be pointed out that in the period from V-J Day down to December 1946 at least 14½ billion dollars net have *already* been loaned abroad at short and long term. Nine billions have come from the United States, almost entirely through government agencies, and 11½ billions have been lent to European countries.⁶ On the above estimate, therefore, some 30 to 35 billions more of international investment are still needed over the next eight or nine years, *in addition* to outright relief operations, political advances and transition-period operations designed primarily to help internal stabilization and the revival of foreign trade. The largest part of the money will undoubtedly go to Europe, but there are obviously also tremendous needs and opportunities in South

⁶ M. A. Kriz, *Postwar International Lending* (Princeton Essays in International Finance, No. 8, 1947). The figures in Table I, below, exclude short-term credits and balances of some 4.3 billions, which are included here in the 14½ billion figure.

America, China, India, Southeast Asia, and under favorable political conditions in Russia.⁷

It is obvious, of course, that if the world's international political relations continue to deteriorate as they have in recent months, discussion of any such volume of future international investment as these figures suggest is a sheer waste of time. I hope and believe, however, that the international political situation will show a marked change fairly soon, perhaps within the next six to twelve months. Either a *modus vivendi* offering a prospect of reasonable viability and stability will be worked out between the democratic and the totalitarian states; or the world will divide into two fairly stable political and economic blocs, that will operate relatively independently of one another. I hope it will be the former, but, in either event, I think the specter of another war will vanish for a considerable period. In either event, also, a large volume of foreign investment among the democratic states will be needed, and will be feasible.

Moreover, the very maintenance of reasonable international political stability in the coming years is itself crucially dependent on a large volume of international investment. There can be no assured peace or security in the present world, either for ourselves or for any nation, when vast masses of the world's peoples are constantly under bitter economic pressure and at the threshold of starvation. Large, enduring and relatively rapid increases in the general levels of productivity, living standards and human welfare are essential. But the only way in which large improvements can be effected quickly is with the aid of foreign capital, equipment and skills. International investment, which requires international political stability if it is to take place at all, is thus in turn a prime requirement for the maintenance of stability itself.

The effectuation of a large volume of international investment in the coming years, therefore, is essential to the most vital interests of the United States, and of every other peace-seeking nation. It is necessary, in order to give us a reasonable chance of helping to create that kind of world for which we fought the war. Given reasonably intelligent planning, execution and terms, I believe that even the magnitudes suggested

⁷ In certain cases problems may develop over the ability of the receiving countries to *absorb* such sums rapidly. The general need is so urgent, however, that I doubt if serious difficulties will arise on this score.

above can be handled without difficulty on a satisfactory investment and repayment basis. I hope that political developments will be such as to make the inclusion of all nations in the program feasible; but if not, that is all the more reason why the democracies should seek to strengthen themselves.

III *The Rôles of Private Enterprise and Government in Future American Foreign Investment*

I shall assume, therefore, that the world's legitimate requirement for international investment over the next decade is on the order of 30 to 35 billion dollars or more, and that this requirement will be met.

Where and how can any such sums be obtained? Great Britain, the traditional lender, seems clearly out of the picture on any large scale, at least for the near-by future. The biggest rôle will undoubtedly be played by the United States. But we will by no means be alone. Canada, Sweden, Switzerland, Argentina, and later perhaps the Netherlands and Belgium are all likely to have substantial parts. Perhaps a quarter to a third of the total will come from such sources as these. The largest portion, however, something like 20 to 25 billions in the next eight or nine years, must come from the United States if it is to be obtained at all. This sum is large, but if spread over eight or nine years would amount to an *average* figure per year which is less than 1½ per cent of our present annual national income.⁸

It seems clear that if the United States invests anything like 20 to 25 billion dollars abroad in the next eight or nine years, neither private enterprise alone nor the federal government alone is likely to carry the whole load. What will their respective rôles be?

To 1939, American foreign investment was essentially a private affair. Since the end of the war, on the other hand, private enterprise has played very little part. From V-J Day through December 1946, government agencies loaned 2,700 millions to other governments in connection with the clean-up of Lend-Lease and other war operations; the Export-Import

⁸ After allowance for the changes in the value of money, it is also not a great deal larger in real terms than the total volume of our new foreign investment in the 1920's, most of which was effected in a somewhat shorter period.

Bank loaned 2,300 millions more; and the Congress, by legislation, authorized the British loan of 3,750 millions. These and other government operations total some 9 billion dollars.⁹ The government has also subscribed 3,175 millions to the capital of the new International Bank for Reconstruction and Development.¹⁰ In addition, there has been a certain amount of direct equity investment abroad by American firms, but the total volume of all private activity has been relatively small.

This recent pattern of American foreign investment, however, will almost certainly not continue. The clean-up of war operations is largely completed, and the Export-Import Bank has used up over 90 per cent of its lending power. It can make large new advances only as existing commitments are repaid or cancelled. If new American foreign investment reaches anything like the suggested total of 20 to 25 billions over the next eight or nine years, a volume which I believe it is in our own most vital interest to achieve, the funds must therefore come from other sources. A substantial part will be obtained, of course, from the sale to American investors of the securities of the International Bank—either its own issues, or issues guaranteed by it. But some portion of these securities will presumably be floated in other countries. The American share may not exceed 6 or 7 billions. This leaves perhaps 15 to 18 billions to be obtained from other private sources and from further government operations.

I know of no way of forecasting today the future importance of private as versus government foreign investment by the United States. In the current international political situation, of course, the public flotation of foreign bond issues in this country on any large scale is almost impossible.¹¹ At the present time, too, the outlook for the flotation of even such issues as the International Bank may wish to put out is any-

⁹ See Kriz, cited above. The figure just given for the Export-Import Bank includes the expansion of its operations in this period in full, although part consists of short- and medium-term credits. It should also be noted that commercial banks have participated extensively in certain types of loans made by the Bank.

¹⁰ Only two per cent has so far been paid in. The United States has also subscribed 2,750 millions to the International Monetary Fund.

¹¹ But a small Norwegian issue has just been announced. (It was successfully floated at the end of April 1947 after the present paper had been delivered.)

thing but bright, despite the guarantees and other security attached to them. Direct equity investment abroad by American firms is also clearly unattractive in general now, although a certain volume of investment of this sort is already going on in special situations. But, as suggested above, it seems to me likely that the international political climate will change markedly in the fairly near future, and that a more stable pattern of international political relations than now exists will emerge. If this happens, then I think that the outlook for private American foreign investment is likely to improve greatly, and that the volume of this investment—especially direct equity placements—may well become large. If this happens, then the lessons of our experience in the 1920's and 1930's with respect to the timing of the operations, flexibility in payment and transfer provisions, and foreign participation (where relevant) must be carefully studied and applied.¹² The American government, by advisory rather than by mandatory operations, should also play an important part.

But private American foreign investment can at best carry only part of the load, and under adverse circumstances may fail to develop in any substantial volume. Then we shall be faced with a major problem in national policy. We shall have to decide, as government and as people, whether and to what extent the requirements of other nations for our funds to carry forward their reconstruction and development programs should be met; and we shall have to decide whether to meet the requirements from advances by our own government so far as private investment does not do the job. As already stated, I believe it is urgent to our own most vital political and economic interests that these requirements, after appropriate appraisal and screening, be met in one form or the other.

Finally, whether our prospective foreign investment programs be private or governmental in form, it is obvious that the government must be responsible for watching over their broad political aspects. What I am suggesting is not, of course, "dollar diplomacy" in the older textbook sense. We should not use investment dollars as a lever to obtain special political advantages or controls which would operate solely in our own selfish interest to the exclusion and disadvantage of all others, or

¹² Also see the conditions and criteria proposed in the League of Nations report on Conditions of Private Foreign Investment (1946).

which would in effect create dependent puppet governments abroad. But we shall be merely naïve if we make investments in foreign countries, the governments of which we believe are committed to broad political objectives hostile to our own, or to programs which seek to overthrow our own domestic institutions or those of governments friendly to us. We should not seek, either by force or by dollars, to impose democracy on other nations with which we are at peace, but obviously we should also not subsidize, directly or indirectly, the enemies of truly democratic government.

One last point is so obvious that it is easily forgotten. If we wish to invest abroad and propose to be repaid, we must—both as government and as people—behave like reasonable creditors. We must not make it impossible for the investment-receiving countries to repay us. We must lower rather than raise our tariffs and other trade restrictions, and we must do everything else in our power to develop and increase that democracy, prosperity and peace abroad, which are the keys to democracy, prosperity and peace within our own frontiers.

TABLE I
INTERNATIONAL LONG-TERM INVESTMENT POSITIONS SINCE 1914¹
(In billions of current dollars)

Creditors	1914	1929	1938	1944	1946
United Kingdom	19.5	18.2	22.9	14.1	14.1
United States	2.5	14.7 ²	11.5	11.4	20.3
Netherlands	2.0	2.3	4.8	1.5	} 4.3
France	8.6	3.5	3.9	1.6	
Switzerland	1.3	2.0	1.6	?	
Germany	6.7	1.1	.7	?	
Others	1.0	5.7	7.5	?	} 38.7 +
World Total	41.6	47.5	52.8	28.5 +	

¹ Arranged in the order of magnitude in 1938. Discrepancies in totals are due to rounding. No adjustments have been made for the successive increases in world prices or for the devaluation of the dollar; and very incomplete account is taken of the actual decline in the current worth of many investments. It is obvious, however, that the *real* value of the world's international investment in 1914 was substantially higher than in 1929 and 1938, and much higher than in 1946.

The figures for 1946 are those for 1944 plus estimated post-war lending to December 1946. The latter lending was largely by governments or governmental agencies. All new Export-Import Bank loans are included; but all other credits and changes in sterling balances, totalling some 4.3 billions, are excluded.

Sources: Eugene Staley, *War and the Private Investor* (1935); Cleona Lewis, *Debtor and Creditor Countries: 1938, 1944* (1945); M. A. Kriz, *Postwar International Lending* (Princeton Essays in International Finance, No. 8, 1947).

² At the end of 1930, 15.0.

TABLE II
INTERNATIONAL OBLIGATIONS ON LONG-TERM INVESTMENT ACCOUNT IN 1938¹
(In million dollars)

Debtor Areas	Creditor Areas								Total
	Europe	USSR	North America	Central America	South America	Asia & Oceania	Africa	Not Identified	
Europe	6,483	1	2,551	..	..	330	97	818	10,280
USSR .....	..	..	10	..	..	5	..	..	15
North America ..	9,136	..	5,695	68	40	182	15	277	15,413
Central America ..	515	..	986	..	..	..	..	59	1,560
South America ..	4,921	..	2,541	..	33	12	..	451	7,958
Asia & Oceania ..	11,746	53	997	..	..	1,784	..	1,060	15,640
Africa	3,872	..	159	..	..	..	..	..	4,031
Other	60	..	..	..	..	..	..	..	60
	36,733	54	12,939	68	73	2,313	112	2,665	54,917

¹ Source: Cleona Lewis, *Debtor and Creditor Countries: 1938, 1944* (1945). This table was compiled on the basis of information on the "non-identified" category which is more complete for the debtors than for the creditors, and the total is therefore somewhat larger than that shown for 1938 in Table I above.

TABLE III
AGGREGATE INTERNATIONAL FINANCIAL POSITION OF UNITED STATES AND UNITED KINGDOM: 1944¹
(End-of-year figures: in billion dollars)

	United States	United Kingdom
Long-term investments	10.6 ²	14.1
Long-term obligations	6.2	2.6
Net investment position	4.4	11.5
Short-term assets	0.5	1.1
Short-term liabilities	6.1	8.9
Net short-term position	—5.6	—7.8
Net international position	—1.2	3.7 ³

¹ Source: Cleona Lewis, *Debtor and Creditor Countries: 1938, 1944* (1945). Sterling is converted to dollars at 4.035. All Lend-Lease and other war-finance transactions are excluded.

² Breakdown: direct (book value), 7.3; foreign dollar bonds (market value), 1.7; miscellaneous private, 1.0; U. S. government, 0.6.

³ By the end of the war the figure for sterling balances had risen to roughly 14 billions. The true present value of the long-term investments is probably materially overstated. The present position, therefore, undoubtedly shows a substantial net deficit.

REMARKS BY THE CHAIRMAN

CHAIRMAN LEFFINGWELL: Thank you, Dr. Angell! This is one of the most important of all the problems that confront the world. As I listened to the discussion of the conditions on which foreign investment should be permitted and encouraged or tolerated, I was reminded of the darky's recipe for cooking fried chicken. The first item was, as you remember, "First catch your chicken." Now, the American investor is going to be hard to catch this time. [Laughter] Remember that after the last war, which was the first world war of great significance in the memory of living man, which seemed to be an unparalleled and an unrepeatable phenomenon, America, like everyone else, thought peace had come back to the world to stay. There were only two enemies: one of them, Austria, was utterly destroyed; the other, Germany, was on her knees. Peace treaties were signed, boundaries were fixed, governments were set for world peace and order for another hundred years at least. Under those conditions, American investment was slow to start but when the door had been opened, under the auspices of the Allied nations, the flow was too fast; and yet, that American investment might have saved the world's economy and its political structure if it had not unfortunately been impossible to maintain political relations on a level basis. As political relations deteriorated in the early nineteen-thirties, people became frightened and there resulted a perverse and reverse flow of capital from the countries that needed it, to whom we loaned our money, to this country, which did not need it and which should have been a lender of money. That was followed by the recalling of the loans that we had made, so that capital ran out at the moment of crisis. That resulted in a condition which we have to remember, and investors will certainly remember in future.

We have been unwise in making loans demanding interest and sinking funds in cases where what the world needs to receive from us, because we are the most well-placed nation on earth, and what we need to give, because we must have a peaceful and prosperous world to trade in, is outright government grants. Until some measure of stability is restored to a world where there is no peace, until governments have dealt with the problems which only governments, acting for all of us, can deal with, private foreign investment will be small and confined to very choice risks. When peace and order come, then, carefully and in moderation, I hope to see our private investments expand again.

PART III

FREE ENTERPRISE—NATIONAL AND INTERNATIONAL

INTRODUCTION *

ELIOT WADSWORTH, *Presiding*

Former Assistant Secretary of the Treasury

I TAKE great pleasure in calling the evening meeting of the Academy to order. I am pinch-hitting for the president of this organization, who is now busy in London on the rather minor occupation of being Ambassador to the Court of St. James. [Laughter]

He is not only president of this organization; he is also president of the English-Speaking Union. I understand there is an internecine warfare between these two organizations to decide which one of them sent Lew Douglas to London. [Laughter] But, anyway, we are very sorry not to have him here tonight. I suggest that we send a cable to him later, saying how much we miss him and how sure we are that his training here as president of this organization will make him a very good Ambassador.

We have been talking at the sessions today about a rather broad subject. When I read the subject, "Free Enterprise—National and International", I thought that it related to something which exists only in a sort of theoretical ether. Yet, it has a very deep meaning for all of us. Justice Brandeis described the greatest freedom of all as "the right to be let alone", which he said is the most comprehensive of rights and the most valued by civilized man.

* Opening remarks at the Third Session of the Semi-Annual Meeting.

It is quite beyond me to define what the Program Committee had in mind, when they chose this title. Perhaps that is why it is such a perfect title, for a day of economic discussion in this period of legal, administrative and legislative confusion. The business man, the professional man, often feels like walking out of meetings, hearings, appointments and inquisitions with the expressive words, "Hell, let me alone and I'll get something done!"

But we are getting a lot done as we thresh out methods of dealing with a jumbled-up world, and I do not believe the world has ever been more jumbled up. In the "good old days", it must have been much more simple.

The other day, I came across an article that was printed in the *Hartford Courant* in 1809. This same paper is still being published in Hartford. I quote it just to show you in what a happy frame of mind the conservative of those days was. The article said: "All free men have a right to manage their concerns in their own way, and government should protect them but not direct, much less obstruct, them, in the exercise of their callings and occupations. The best government can do very little more toward the prosperity of the people than to afford them general protection from injustice and injury in the undisturbed employment of their time, talents and property."

It sounds a little like a Republican campaign speech of some years ago. [Laughter]

"A wise government is the people's guard, and it takes effectual care that there should be none to police or annoy, none to interrupt them in their lawful callings and pursuits. Thus guarded, there is full scope and also sufficient encouragement given for industry and enterprise. Each individual employs himself as he finds it most to his own advantage and each, in advancing his own interest, by honest industry, adds to the common stock.

"A nation resembles a swarm of bees. The bees must be well hived, protected from external and internal annoyance and injury, and left free as air to make their combs, construct their cells and labor in hive or field according to their own liking. Thus protected and thus free, they seldom fail to treasure up honey. But who makes the honey? Not the guarders of the hive but the bees themselves, so civil government, however wise

and vigilant, is not the direct and efficient cause of the nation's wealth, which is, in fact, produced by the great swarm, the people. On the other hand, should the keeper of the bees undertake to dabble in their private concerns, interrupt their labors or divert their wonted course of enterprise into new channels, should he foolishly do this, he would find little or no honey in the hive at the end of the war." [Laughter]

There must be some conservatives here! [Laughter]

"It belongs to government to protect commerce, to guard it by a few gentle regulations and there leave it. The skill of the merchant will do the rest. All history testifies that trade flourishes most where it is most free, and that it soon leaves the nation that shackles it."

I present this as a delightfully simple definition of free enterprise, as it was then preached and practiced. But at that time our population was about seven million; the expenses of the national government were about fifteen million and our national debt was only sixty million dollars. There was plenty of elbow room for the individualist, and we worked on that general idea.

There is not much left today of the precepts laid down in the parable of the bees. The wise government referred to has found it necessary to police and often annoy free enterprise in carrying out its duty as the people's guard. To list these molestations would take too long, but you have the Interstate Commerce Commission, the Federal Trade Commission, the anti-trust laws, the SEC, the factory laws, the sanitary laws, the CAB, the CAA, and, of course, we all could add a great many to that list. It is often said in political speeches that someone took away our freedom when they passed these laws regulating us. But what has really happened is that the human swarm grew greater and lived nearer together, making rules of behavior necessary.

We have to get along together. Lord Northcliffe is reported to have said that the American people do precisely as they please, and if they do not, the government makes them. [Laughter]

The parable of the bees does not make a very good lesson for us. The bee swarm is more crowded than the human swarm. They are very ruthlessly regimented. When there is a surplus of population, the drones—and that means all the males [laughter]—are simply cut off from nourishment by the work-

ers, excluded from the family life and left to perish. The workers support their queen in the style to which she is accustomed. They are so desperately driven in their work of production that they burn themselves out within a few weeks and leave the hive to die.

Now, I do not believe that that is a very good example of modern civilization. The instinctive regulations that guide the bee swarm are the same today as they were thousands of years ago, when bee history was first recorded. The human swarm has been infinitely elastic and resourceful. The carrying on of free enterprise, national and international, over the centuries has developed rules and regulations written for the general good, based on experience, to meet the new conditions brought on by steam, electricity, the motor and the airplane.

The words "free enterprise" do not necessarily mean, as Justice Brandeis said, the right to be let alone. The human swarm has long since learned that there must be traffic lights and a thousand other rules, great and small, to keep life in a smooth and orderly way.

We are all wondering what is wrong with the present situation, what the difficulty is. I wonder whether it is because we are trying to write new rules today to meet an entirely new world situation. Just think what we are trying to do. We are trying to draw up the most far-reaching regulations and traffic lights ever essayed by man. In politics, the Big Four in Moscow struggled even to make a beginning on the opening paragraph of the European peace. In the banking field, which we heard about today from Randolph Burgess, the International Bank and the Fund venture timidly on the thin ice of bringing order into international finance, something that has never existed before. In Geneva, the Trade Conference tentatively spread its wings in other fields. We have created international organizations which must teach us to walk together.

This effort of nations to implement free enterprise, national and international, is the greatest adventure upon which mankind has ever embarked. That is why the topic of this meeting is so timely, and, I may add, so elusive. I want to make clear to you that I do not understand how we are going to write out all these new regulations, but we have got to write them out or go back to where the bees were in that parable.

We have two speakers this evening who, perhaps, will clear up these points that I have been raising. They are extraordinarily well equipped to deal with the situation.

The first speaker is Philip D. Reed, Chairman of the Board of the General Electric Company. Mr. Carmichael and I were just marveling at his youth. He graduated from the University of Wisconsin in 1921. After practicing law a few years he joined the General Electric Company as Assistant to the President. Then he succeeded Mr. Young in 1940, served in the Office of Production Management in 1941, was senior consultant to the Director of Priorities in 1942, Chief of the Bureau of Industries Branch of the WPB, went to London as Deputy Chief to the Harriman Mission, was Chief of the Mission of Economic Affairs, and then returned to the quiet and peaceful life of Chairman of the Board of the General Electric Company at the end of the war. [Laughter]

It is a great pleasure to have him here. I am delighted to introduce Mr. Philip Reed, who is also the Chairman of the United States Associates of the International Chamber of Commerce, and is about to go to Montreux, Switzerland, to meet with a number of his peers from different countries to help solve this situation. [Applause]

REMARKS BY MR. REED

MR. PHILIP D. REED: Mr. Chairman, Distinguished Guests, Ladies and Gentlemen: Mr. Wadsworth is always generous in his introductions, and no less in this case. I am deeply grateful to him.

CAN WE PRESERVE FREE ENTERPRISE IN THE MODERN WORLD?

PHILIP D. REED

Chairman of the Board of General Electric Company
Chairman of the United States Associates, International Chamber of
Commerce

THOSE of us who were old enough to fight in World War I and not too old to take an active part, fighting or otherwise, in World War II have much to be grateful for. Born in the last decade or so of the nineteenth century, this generation of Americans has seen more and done more, has been lifted higher and plunged lower than any other generation in recorded history. And it still has twenty working years, more or less, to go!

Since one of the few things we cannot yet do in this old world of ours is to pick the period in which we are going to spend our lives on it, we can at least tip our hats to our parents for letting us in on an era which has not been characterized by its dull moments so far and which gives promise of being a really ding-dong affair for the rest of our active days.

It is a seasoned generation that fought one great war to end war and found it did no such thing; that saw prices skyrocket and was scared by its first adult taste of depression in 1920 and 1921; that learned to handle its alcohol the hard way, with bathtub gin and hip flasks and speak-easies; that saw the business and stock market "new era" of 1928 and 1929 collapse into the ghastly economic paralysis of the early 1930's, which in turn brought on the New Deal with much that was good socially and much that was evil morally and economically; that witnessed the rapid growth of nationalism and protectionism all over the world and wondered a little at the progress and improvement that accompanies the first stage of a dictator's régime; that observed the utter impotence of the League of Nations, America abstaining from membership, to prevent aggression or to apply sanctions against the aggressor; and, finally, having experienced World War II and seen the waning *Pax Britannica* come finally

to an end, has turned its back on isolationism, supported every measure aimed at restoring and maintaining economic and political stability in the world and is at this moment soberly preparing to accept the grave economic and moral responsibility for the leadership and, when asked and needed, the protection of free peoples everywhere.

Yes, it is an experienced and sophisticated generation. It should have, and I believe it has, developed nerves and minds and hearts that are, in the parlance of the sports world, "tournament tough", that can and do take it however stiff the competition.

This preliminary comment on the generation of which I and a majority of this audience are members is perhaps uncalled for. I started out to say how fortunate we are, and I am afraid I ended by saying how good I think we are going to be.

Another thing I had in mind was to indicate what a kaleidoscopic period we have been through, how accustomed we have had to become to change—change of conditions and not infrequently change in our own views. There is nothing hidebound about America today. And that is as it should be.

Take, for example, this thing we call, variously, free enterprise, private enterprise, free competitive enterprise, competitive capitalism, etc., etc. These same terms have been used to describe our economic system for many years, but the rules under which that system has operated, the degree of freedom it has enjoyed, have changed enormously in the past sixty years. The business men of the 1880's functioned under entirely different conditions and ethical standards than we do today. Each succeeding decade brought changes in the rules, and the cumulative change is very great indeed.

In part this is accounted for by the growth of undesirable business practices which such laws as the Sherman Act of 1890, the Clayton and Federal Trade Commission Acts of 1914, and the Robinson-Patman Act of 1936 were designed to correct. But principally it is accounted for by the very rapid development of our industrial economy, each stage bringing untold and unanticipated complexities which seemed to call for this or that or the other legislation, often to assist or protect, and frequently to regulate, business enterprises in their relations with other businesses or with their employees or the purchasing public.

The New Deal added many new restrictions, some of them desirable, to the already burdensome array. Then came the war which brought an end to our free-enterprise economy for the duration. With the government alone needing, ordering and buying more food and manufactured products than this country had produced for all purposes before the war, and with high civilian purchasing power coupled with severe shortages of many civilian items, it was necessary and proper that the government should control, regulate and ration the human and material resources of the country to whatever extent was required. And, as we all know, the degree of regulation and control was very great.

Indeed, many people believed that our free-enterprise society had gone the way of all flesh. They feared that the functions of buying and selling, of allocation of materials, of control of prices and regulation of wages which the government had assumed during the war would be so largely retained that private business would not have sufficient scope or freedom of action to venture and grow and prosper in the traditional American way.

Well, so far these viewers-with-alarm have not been justified in their fears. We have had our troubles, heaven knows. A year ago things looked very black indeed. Unsound governmental action was predicated on equally unsound prognostication. Collective bargaining was a meaningless shibboleth. Strikes were everywhere and production, the key to all our ills, was down instead of up. OPA prices were unbalanced; many of them had no relation to cost and were seriously hampering the production of many essential products and components. Black markets were flourishing. Everyone, except a few labor leaders, was blue and discouraged.

How different, how very different is the situation today. Government controls have to a very considerable degree been cut away. Production is at record levels. Strikes, despite the coal and telephone interruption, are at a new low. The people of this country have clearly demonstrated at the polls and elsewhere that a free-enterprise economy—not a socialized nor even a too regulated one—is what they want. There is indeed some danger—refreshing, perhaps, but still a danger—that Congress will go too far in its effort to restore the balance of bargaining power between management and labor and to protect the general

public against the crippling effect of nation-wide strikes in vital industries.

There is also the heartening awakening on the part of millions of people to the fact that many posts of leadership in our labor organizations and elsewhere are occupied by men who do not have the interests of either labor or America in their hearts, but rather the single objective of stirring up class hatred, bitterness and confusion in compliance with the policy and technique of a foreign government.

These are immensely encouraging developments, and we will do well to pause and take heart from them as we face the by no means insignificant problems that remain. It is clear that this country has decided that the free-enterprise system, despite its weaknesses and faults, is better for the great mass of our people than any other we know about, and that we shall try again to operate that system in a way which will bring us its proved benefits and strive mightily to minimize and damp out the disadvantages of its inherent instability.

This decision is perhaps the wisest one America ever made, and it comes at a time when the rest of the world is moving in the opposite direction. History may well record that this decision of ours not only saved the free-enterprise system for ourselves but launched a demonstration of its vigor and capacity to benefit mankind that reversed in due time the world-wide trend toward government ownership and operation.

As I have said, the outlook for free enterprise abroad is far less encouraging. In all countries most of the wartime controls have been continued and in many countries they have been actually extended. This was by no means done entirely on ideological grounds. The facts are that in many countries of the world the destruction or wearing out of production facilities during the war and the natural weariness of the people have made it impossible to produce even at the pre-war level. Coal is the most serious bottleneck almost everywhere. But even if coal were ample, the enormous need for new productive capacity, for housing, for transportation equipment and many other categories of capital goods would find most of these countries faced with continuing serious shortages of consumer goods of all kinds. These circumstances coupled with the need to husband a limited and diminishing supply of foreign exchange to purchase essential foreign raw materials and food stuffs have forced most governments to continue rigid controls.

But in addition to these stubborn facts, there has been in most foreign countries a deliberate ideological swing to the Left. Many formerly free-enterprise economies are now experimenting with the so-called mixed economy in which the government owns and operates the great service industries—transportation, power and light, communications, etc.—controls the banking system and, in addition, certain key industries such as coal and steel. The remaining industries, and they represent the bulk in terms of volume and value of their business, continue to be privately owned and operated. The question is: can a mixed economy continue to be mixed? Can the lines between government and private ownership be so clearly defined that private business will not find itself in the hopeless position of competing with the government, and that government will not find itself forced gradually to extend its area of control or subsidy in order to implement its own undertakings?

Although I have strong views on this subject, it is not my purpose to debate that issue tonight. I wish simply to make the point that this trend toward government ownership is not to be taken lightly here at home. Our trade with the rest of the world, including the purchase of many foreign raw materials that are essential to our own domestic operations, although not a large fraction of our total trade, is nevertheless an essential fraction. Were we to find that our imports could be obtained only by buying from foreign governments and that our exports could be sold only to agencies of foreign governments we would soon appreciate the impossibility of dealing individually as private enterprisers with government monopolies. In self-defense we would have no alternate but to appeal to our own government to act for us collectively or to authorize us to act collectively under government supervision. To do this would strike at the very roots of the system we are seeking to preserve.

To put it another way, it may be seriously doubted whether a sound and virile free-enterprise system here in America could long remain sound if the other countries of the world resorted to government operation and state trading. Just as a sound and healthy apple in a basket of spoiled ones quickly spoils, we must be conscious of the risk to our system should the socialist trend abroad continue.

So what do we do about it? Clearly, I submit, there are two things that must be done.

First, we must demonstrate by clear, irrefutable performance that this country's decision to return to a free-enterprise economy after the war was the right decision. This means, of course, that we must make our system work as it has never worked before; we must produce as we never produced before and we must produce so efficiently that reduced costs will be promptly followed, not next year but this year, by an orderly decline in prices. High production means high employment, and declining prices under these conditions mean a rising standard of living. In addition, we must devote ourselves untiringly to the study of ways and means of minimizing the fluctuation of market demand for goods and services. There is no simple formula for doing this; but the elements of the problem are known, and the responsibility for moderating business fluctuations and maximizing employment rests on no one group or agency, but on all together—government, business, agriculture and labor. This responsibility can be successfully discharged only by cordial and continuous coöperation between these groups to promote the necessary conditions and policies in the common interest of all. Toward that end we must strive as never before. There is no surer way to protect free enterprise here and to revive it abroad than for us to make it work gloriously.

The second thing we must do is to sell free enterprise just as we would our finest product. We must lift the level of understanding both at home and abroad of what the free-enterprise system is, what it is not, and how it benefits the people who live under it. We must somehow get these elementary truths across, not only to the people of other lands but to millions here at home who do not understand it, if we are to generate a powerful demand and desire for its retention. To do this the simple elements of free enterprise and the actual human benefits it has brought must be described simply and briefly in words all of us can understand. For this purpose the complicated parlance of the economist and technician just will not do.

I noticed in the paper the other day a story attributed to Dr. George R. Harrison, Dean of the Massachusetts Institute of Technology, which illustrates this point. It appears that a foreign-born plumber in New York City wrote to the National Bureau of Standards that he had found hydrochloric acid did a good job of cleaning out clogged drains.

The Bureau wrote: "The efficacy of hydrochloric acid is indisputable, but the corrosive residue is incompatible with metallic permanence."

The plumber replied he was glad the Bureau agreed. Again the Bureau wrote: "We cannot assume responsibility for the production of toxic and noxious residue with hydrochloric acid and suggest you use an alternate procedure."

The plumber was happy again the Bureau agreed with his idea. Then the Bureau wrote: "Don't use hydrochloric acid. It eats hell out of the pipes."

If someone could put the case for free enterprise as simply and effectively as the Bureau made its point on the third try, all would be well. That, perhaps, is too much to hope for. But real progress has been made, and much more must be made in developing techniques for making people understand what our system is and why and how it benefits them; and the bulk of this load must be carried by business.

With your company and mine this job begins at home, that is to say our own employees, our stockholders and the people of the communities where we have plants and offices. Today a business, be it small or large, which has not assigned to an officer or department of the company the direct responsibility for explaining that business—how it works, how it prices its product, the elements of cost and profit that are included in the price, and the problems with which management are confronted—is failing to pull its weight in the boat. We business men spend enormous amounts of time, energy and money in persuading the public to buy our products. We have been seriously and dangerously delinquent in not devoting enough time, energy and money to explaining to our employees and to the teachers, doctors, ministers, housewives, shopkeepers, civil servants and all the others in the communities in which we live the simple facts about our business and the kind of people who manage it.

This is not an easy job. It requires the best skill and brains we have. It calls for a carefully conceived program and a high degree of imagination; it calls for an even higher degree of persistence. Time is of the essence.

Turning now to the foreign field, the task is, of course, a different one. Let me cover that phase of the matter by saying a word about an appropriation request that is at this moment before the Appropriations Committee of the House. The item I

refer to is the approximately 30 million dollars requested by the State Department for its so-called Office of International Information and Cultural Affairs.

The objective of that Office is simple and clear. It seeks through the several instrumentalities of communication—the radio, the motion picture, the press and publications, the maintenance of libraries and the international exchange of persons, as well as through a close working relationship with UNESCO—to lift the level of knowledge and understanding about the United States among the peoples of the world.

The question before the Committee, and I am told many members are not favorably disposed, is whether this activity is sufficiently essential to the interests of our country to warrant the intelligent spending of 30 million dollars on it next year. I strongly believe that it is for the following reasons.

My starting point, and this may seem a little remote, is the statement that I believe America must maintain a strong modern military machine. We must not only *be* formidable—and, if possible, *the most* formidable—in land, sea and air forces but we must be *known* in the capitals of the world to occupy that commanding position.

The reason for this is, of course, that a powerful military establishment is an insurance policy against war. Its very existence is a potent deterrent to warlike acts by others. That it should be necessary at this stage of the development of human civilization to carry insurance against war is unfortunate to say the least, but, in the light of the first-hand experience of two generations now living, few would dispute the fact that the necessity is very real.

The dreadful thing about this insurance is that it costs so much. During the fiscal year ending June 30, 1947 the American people will pay 10 per cent of the total national income and almost 50 per cent of the federal government's total tax receipts for the support and development of our Army, Navy and Air Forces exclusive of veterans' benefits. And for the fiscal year 1948, exclusive of veterans' benefits, 11 billion, 200 million dollars has been requested for our military forces. This is the premium we are being asked to pay on our insurance policy against war. And it will have to be continued so long as the risk of war continues.

Now, if you and I were using half of our total income to pay our fire, automobile and accident insurance premiums, we would be giving a great deal of thought to it and putting a great deal of heat on the government to adopt measures which would reduce these hazards and thereby make possible a substantial reduction in the cost of that insurance. This, precisely, is what we must do to reduce the cost of our war insurance. For only as the *risk* of international warfare is reduced will it be possible to cut the terrific premium on our war insurance policy to more reasonable levels.

Reducing the risk of war is obviously no short-term undertaking, nor a simple one. The United Nations organization with its galaxy of specialized agencies will attack the problem on many fronts, politically, economically and socially. This represents a splendid beginning, but it is just that. Many years will be required to develop the potentialities of the United Nations to the full. In the meantime, and while giving fullest support to these organizations, America must complement and supplement their endeavors with direct, consistent action aimed at establishing and maintaining sound and friendly relations in the world.

This raises the question, should more, or less, be done than is being done to tell the peoples of the world about our country and our way of life? Is it important from the standpoint of reducing the risk of war? And, if so, what part, if any, should the government play in it?

As to the first, let me say just this. I spent two a half years in wartime England as Chief of the United States Mission for Economic Affairs. This gave me an exceptionally good opportunity to observe not only the attitude of the American and British people toward each other but, more importantly, the happenings and events which had the greatest effect upon that attitude.

I can say with complete conviction that very much more ill feeling was generated on both sides of the Atlantic by the publication of downright untruths, half-truths and baseless rumors about each other than by any real disagreements between us. Time and again statements were made, sometimes by perfectly honest, well-meaning people, that simply were not so; and I was in a position to know, having access to the facts on both the British and American sides. Time and again the great need for

more accurate and adequate information was brought home to me.

Another way to test the importance of getting our story across to the peoples of the world is the extreme importance which Russia and certain of her satellites attach to creating a false and unfriendly impression of America in the minds of these same people. If it is worth their time, effort and millions falsely to describe us in order to arouse fear and suspicion and so that they may appear to advantage by contrast, it would seem an obvious and important step in pulling the teeth of this unfriendly influence to tell the truth about both ourselves and our slanderers.

Within the past fortnight I have talked with the heads of several large manufacturing companies in France, Italy and certain Balkan countries. Although the Communist influence and resulting suppression of news from the United States is greater in some countries than others, these men were unanimous in their view that there is a serious and significant dearth of information about the United States, the things we are doing and the leadership we are undertaking to provide. They point out that we have already rendered a great deal of help through UNRRA, through our surplus military supplies abroad, and through loans, but from the standpoint of their people these things have been done silently, almost secretly. Particular mention was made of the need for more information about the way of life and standards of living of the working people of our country. All of them spoke of the heartening reaction to the President's recent message on Greece and Turkey and of the importance of getting this message into the grass roots of every country.

These are typical of the views I have gathered from many people of a dozen countries. All of them confirm my convictions that the simple truth about the United States, widely told throughout the world, will do more to reduce the risk of war, and thus to reduce the need for a multi-billion dollar military force, than any other single factor.

If we may assume then that the job needs doing, what part, if any, should the government play in implementing an international information program?

It must be obvious to you as it is to me that the great bulk of the task of transmitting information abroad is and should be borne by private agencies and individuals. The press, the motion picture industry, the radio broadcasters, publications of all

kinds, individuals traveling into and out of our country, business organizations with foreign branches in constant communication with the home office, educational institutions having international exchange arrangements, all contribute to the flow and dissemination of information abroad.

In the case of most of these agencies, the transmission of information is incidental to their central purpose and objective. While the coverage and volume are undoubtedly great, there is no coördination between the agencies, nor is there anyone to see that all areas and all subjects are adequately covered. The old saying that everybody's job is nobody's job has application here.

My conception of the part the government should play in this great undertaking is to fill in the gaps that for one reason or another have been left by the many nongovernmental agencies which are providing the bulk of the coverage. Let me give you an example in a field I know something about, international short-wave broadcasting.

All reports confirm the fact that our foreign radio broadcasting activities are woefully inadequate both in content and in the quality of the signal. Other countries, Britain and Russia, for example, are doing a very much more effective job than we are on the Continent of Europe. But inadequate as it is, our foreign broadcasting would shrink to a small fraction of the present output if the government withdrew its support and private broadcasters were relied upon alone. The reason for this is that in the present state of international broadcasting and foreign trade the operators of private broadcasting facilities would be unable to obtain commercial sponsorship of foreign broadcasts in sufficient amount to finance more than a small fraction of the hours currently devoted to such broadcasting.

In these circumstances it would appear that the only satisfactory solution is to develop international broadcasting to the desired level through a government financed organization which is divorced from the operating departments of government and is given maximum freedom of action, program time being available both to the government and to private sponsors. Operating on this basis, there is good reason to believe that, as trade expands and international broadcasting and the foreign radio audience grow, more and more of the broadcast time will be purchased by commercial sponsors and the job of providing adequate foreign informational service will gradually revert to private agencies.

The same situation exists with certain kinds of news material, with certain types of motion pictures. It will be found also with respect to particular areas of the world. I say again that I am unalterably opposed to the government's providing any foreign informational services which can and will be adequately supplied by American private enterprises and institutions. But I am equally convinced that the government must undertake that part of the informational job which private agencies and private capital cannot afford to do. Only thus will we do a balanced job of telling the truth about ourselves and of bringing the peoples of the world into closer, more understanding and friendlier contact. Only thus will we reduce the risk of war and the colossal cost of our military establishment. Looking down the years, nothing is more important than that we do this.

And so I return to the beginning—can free enterprise be preserved in the modern world? You know my answer. Of course it can. But as free enterprise itself is a dynamic thing, the synthesis of the hopes, courage, brains and toil of millions upon millions of people, so also will its life depend upon those same millions knowing what free enterprise means to them, knowing what its loss would mean to them, and acting on that knowledge.

REMARKS BY THE CHAIRMAN

CHAIRMAN WADSWORTH: Thank you, Mr. Reed! I think Mr. Reed knows a good deal about free enterprise and what we ought to do to protect it.

And now, I have great pleasure in introducing our last speaker, who is a newcomer to New York. He comes from a career as an educator. He has been Chancellor of Vanderbilt University for the last ten years. I had the great pleasure of being associated with him on the Central Committee on the Red Cross all through this war. He has had foreign experience because he went to England as a Rhodes Scholar just before World War I, served with the Commission for Relief in Belgium, served with the British in India, served in East Africa as an honorary captain in the British Army, and then had two years in our own Army. He is now President of the Carnegie Foundation for the Advancement of Teaching.

I am happy to introduce Dr. Oliver C. Carmichael, who will speak on "Barriers to Free Enterprise". Dr. Carmichael! [Applause]

BARRIERS TO FREE ENTERPRISE

OLIVER C. CARMICHAEL

President, The Carnegie Foundation for the Advancement of Teaching

FREEDOM is an intriguing word. It represents the most ancient aspiration of civilized man; at the same time, it is the liveliest topic of our day. It is the ideal around which have revolved the great issues of Western civilization since the Middle Ages. Man's determination to achieve it burst the bonds of ecclesiasticism which had shackled progress for a thousand years and ushered in the Renaissance. The great reforms, social, economic and political, over the past three hundred years have been inspired by this ideal, the most persistent and the most powerful force in human society. Yet there is confusion in the use of the term. Two conceptions have prevailed and have been used interchangeably, frequently without recognition of their difference.

Rousseau defined it in terms of the rights of the individual to follow his own impulses to respond to natural desires and inclinations, in short, to do as he pleases. It is the basis of the theory of unbridled individualism. On the other hand, the classical definition recognizes that all liberty is based upon restraints. Law and order are prerequisites. Without controls liberty becomes license, which leads to anarchy. The conflict between these two conceptions has led to misunderstanding. The strange paradox is that absolute freedom of the individual is self-destructive; it can exist only when it is limited. Robinson Crusoe was the only free individual of which there is record, and he existed only in Defoe's imagination. The fact is, then, that no one desires absolute freedom or uncontrolled free enterprise. It must be subject to limitations in order to exist at all. It is one of those semantic difficulties which we have inherited from Aristotelian logic.

What we really mean when we speak of freedom of the individual or of enterprise is the maximum freedom consistent

with the welfare of others and of society in general. The controversy arises over how much control is necessary and how it is to be applied. The changing structure of society demands constant revision of our judgment on both counts. The rapidity of those changes and their far-reaching character complicate the problem. The substitution of mass production for hand manufacture, a rural for an urban society, a nation of self-employed for a nation of employees, and the expansion of the boundaries of communities through improved means of transportation and communication, are among the basic changes affecting the amount and method of controls necessary to the smooth functioning of our economy. Over and above those changes which have modified the relationship of government to the individual a severe depression followed by war greatly augmented the controls imposed by government. The legacy of these two catastrophes expresses itself in many restrictions on outlook and on action, which hinder the fullest development of our traditional economic system. A brief analysis of the effects of the depression and the war will serve to illustrate.

A vast increase in independent administrative agencies which have virtually legislative, executive and judicial powers is one of the most serious inroads upon tradition of the past decade. Broad discretionary powers entrusted to commission members result in a government of men rather than of laws. More than a hundred such commissions in daily operation affect profoundly the functioning of democratic processes. They are not all bad, of course. Some have been in existence many years, but the extent to which the device has been used in recent years is a matter which calls for adjustment.

Another effect of war and depression is a changed attitude on the part of government toward both labor and management. The regulation of wages and hours, of production and prices, and many other forms of control in industrial relations, have grown up under stress of emergency. The effort to control output seems particularly dangerous. When government undertakes to balance production with consumption, it inevitably leads to assignment of quotas to producers which not only stifles their freedom but prevents the establishment of new enterprises. Undoubtedly there is need for many readjustments of our thinking with respect to government relations to

both management and labor. The tendency of government to play too great a rôle in industrial relations could easily undermine the foundations of democratic society if allowed to grow.

Speaking of tendencies, I am reminded of Robert Frost's aphorism. He said: "I hate a tendency; the minute you get on one it seems to start right off accelerating." That appears to be the habit of emergency measures adopted in time of crisis.

Price control, which was undoubtedly necessary during the war and which is now being relinquished, has no place in a stable and balanced economy. It is a matter which cannot be handled by general statutes. It must be left largely to administrative decision. Controls exercised by individuals as a permanent policy are undoubtedly the negation of economic democracy. The danger is that having become accustomed to its operation in wartime the average citizen may not recognize its true significance when it is suggested as a remedy for peacetime ills.

Another residue of the depression-war years is the subtle influence of the break with tradition implicit in the tendency to deal with people as groups rather than as individuals. The interests of special groups, such as labor, management, consumers, are pictured as antagonistic. Solution of the problems which arise is sought frequently not in terms of the public welfare but on the basis of bargaining among the different groups. Somehow the focus must be changed. It is not the group that matters; it is the individual. If his rights and responsibilities are accentuated, are kept in the forefront, in all efforts at the solution of our problems, the results are likely to be more satisfactory to all parties—the individual, the groups and the general public.

Time will not permit elaborating further on the obstacles to a free economy inherent in the changes which the two great emergencies of recent memory entailed. Sufficient has been said to indicate the general nature of the problem of adjustment which faces us now. My deep concern is that no consistent and comprehensive effort is being made to solve it. Who knows what controls could be lifted with safety and with profit to us all? Vast and continuing research is needed to discover the basic essentials of a proper adjustment, the defects which must be eliminated, the weak places that need

strengthening. Which regulations constitute barnacles on the ship of state, and which serve useful purposes? There is no body of scientists devoting their undivided attention to answering these questions. Society is too complex and the problems of our day too acute to leave their solution to the sporadic efforts of isolated scientists. A national nongovernmental commission composed of scientists, scholars and statesmen, dedicated to the task of finding the answer to the question—What are the limits of freedom in modern society?—might produce results as important to the world, even though not as startling, as the Manhattan project.

Defining the meaning of freedom and free enterprise under the changed conditions of our time is not the job of American business alone, or of American labor, or of the federal government. It is the task of American society as a whole, and that in a particularly critical time. If the arsenal of democracy in war is to become the citadel of democracy in peace, realistic, comprehensive and concerted effort will be required.

It is worthy of note in this connection that in the debate on the Science Foundation bill opposition developed to the inclusion of the social sciences. Millions for chemical, physical and biological research, but little or nothing for investigation in the field of human relations. Two world wars in a generation with all their cost in blood and treasure and in human suffering have not been sufficient to wake us up to the fact that the science of human relations is more important today than the sciences concerned with the natural world. If a government foundation is unable to deal with the delicate problems of human behavior, then perhaps some voluntary agency representing all elements of American society could be formed to undertake it.

We quibble over the words "social science". We query whether there is a body of knowledge concerned with human relations, that deserves to be called a science. We shy away from the use of the word *social*. It has a bad connotation. It is again a matter of semantics. Whether there is anyone entitled to be called a social scientist, or whether there are disciplines that can rightly be called social sciences, I am not concerned. That there are problems in our society, which require painstaking research and investigation, the solution of which is

of paramount importance to us all and to the world, there can be no doubt.

Lack of knowledge and understanding then is the first stumbling block to the flowering of our economic system. Closely related to that is another more subtle and more insidious influence. It is lack of interest; indifference to the preservation and promotion of the maximum freedom consistent with the welfare of society. It expresses itself in the failure to exercise the right of franchise, in the lack of esteem for public office and political service, and in a general lack of a sense of social responsibility on the part of citizens. Rights and privileges loom larger in our thinking than duties and responsibilities.

There was a certain collective enthusiasm for the notion of free enterprise that dominated the American scene for the first century of our national life that has somehow lost its vitality in recent decades. Dependence upon collective action to achieve desirable goals, which began about 1870, has resulted in weakening the traditional zest for individual freedom that existed earlier. Security seems more important. Monopolies were formed and high tariffs enacted to assure the maintenance of the price level, to make profits secure. Labor organizations sprang up for the purpose of stabilizing wages, improving working conditions, and insuring greater certainty of employment. Pressure groups were formed to influence legislation. In all these combinations of power the individual gave up some elements of his independence in order to achieve his purpose.

Security is a worthy goal. It serves to free the individual and adds to his happiness. The contributions made through legislation over the past two decades toward greater security for all elements of the population are achievements in which we all take pride. They represent great advances in our economy. Though social security laws are burdensome on business and industry, no forward-looking leader would advocate their abolition, because they meet such obvious social needs. They are essential to a well-regulated economic order. It is the goal of both domestic and foreign policy. International security is the hope of the United Nations. In the literature of our day security is the magic word. It represents the universal longing of mankind in a great transition period.

The implications of this overwhelming emphasis are, however, worthy of consideration in this discussion. Undoubtedly there has been a shift in American thinking from freedom to security. The latter occupies a much more prominent place in our vocabulary today than it formerly did. Does it mean that it appears more important to the average American than the earlier ideal? If it does, free enterprise is in peril.

When our predecessors settled on the Atlantic coast and began to push forward toward the Pacific, they did not ask for security, but only for the right to take a chance. It was that spirit which wrought miracles. As long as men are dominated by the venturesome and creative outlook, free enterprise will survive, however complicated life becomes. Discoveries which free inquiry makes possible can never conspire through their influence on society to destroy the system that gave them birth. This is the bedrock of our faith in a free society. Knowledge of its principles, devotion to its purposes, and vigilance in its services are the price of its preservation.

REMARKS BY THE CHAIRMAN

CHAIRMAN WADSWORTH: Ladies and gentlemen, this is the end of the spring meeting of the Academy. I want to thank all of the speakers who participated, particularly the two speakers this evening, who have certainly gone very deeply into the serious problems that confront this country and, in fact, all of the world. On behalf of the Academy, I declare that this particular session is ended.